Supreme Court, U.S.
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No.

In the Supreme Court of the United States

IRWIN MORTGAGE CORPORATION,
PETITIONER,

v.

JOHN ROBERT CULPEPPER, PATRICIA STARNES CULPEPPER, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, AND BEATRICE N. HIERS, INDIVIDUALLY AND AS A REPRESENTATIVE OF A CLASS OF SIMILARLY SITUATED INDIVIDUALS,
RESPONDENTS.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

MAUREEN E. MAHONEY
NESTOR M. DAVIDSON
LATHAM & WATKINS
555 ELEVENTH ST., N.W.
SUITE 1000
WASHINGTON, D.C. 20004
(202) 637-2200

*ALAN H. MACLIN
ROBERT J. PRATTE
BRIGGS AND MORGAN
2400 IDS CENTER
80 SOUTH EIGHTH STREET
MINNEAPOLIS, MN 55402
(612) 334-8400
*Counsel of Record

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QUESTIONS PRESENTED

The Eleventh Circuit held that the question whether "yield spread premiums" paid by home mortgage lenders to mortgage brokers represent illegal kickbacks under Section 8 of the Real Estate Settlement Procedures Act of 1974 ("RESPA"), 12 U.S.C. § 2607, may be resolved on a class-wide basis. The court based this holding on its conclusion that the standard governing liability for illegal kickbacks—promulgated by the U.S. Department of Housing and Urban Development ("HUD")—can be satisfied without proof that the amount of the yield spread premium, in combination with any other fees paid to the broker, exceeded the market value of the goods or services actually provided by the broker in connection with the loan transaction. In response to the court of appeals' decision, HUD issued a clarification of the governing standard that expressly rejected the holding of the Eleventh Circuit. This petition raises two issues:

1. Whether this Court should grant the petition, vacate the judgment below and remand to the Eleventh Circuit to reconsider its decision in light of HUD's intervening clarification?

2. Whether the court of appeals erred in affirming class certification under Federal Rule of Civil Procedure 23(b)(3) because it erroneously interpreted the standard governing liability for the payment of yield spread premiums under Section 8 of RESPA?

PARTIES TO THE PROCEEDING

The petitioner is Irwin Mortgage Corporation, formerly known as Inland Mortgage Corporation. The respondents are John Robert Culpepper and Patricia Starnes Culpepper, on behalf of themselves and all others similarly situated, and Beatrice N. Hiers, individually and as a representative of a class of similarly situated persons.

CORPORATE DISCLOSURE

Irwin Mortgage Corporation is an Indiana corporation, and a wholly-owned subsidiary of IFC Mortgage Corporation. IFC Mortgage Corporation is a wholly-owned subsidiary of Irwin Financial Corporation, a public corporation.

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Irwin Mortgage Corporation ("Irwin") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 253 F.3d 1324. The opinion of the district court granting class certification (Pet. App. 16a-27a) is reported at 189 F.R.D. 668, and the subsequent order of the district court granting a stay pending appeal, 1999 WL 1135127 (Pet. App. 28a-36a) is unreported. The decision of the court of appeals on a prior appeal reversing a grant of summary judgment for Irwin (Pet. App. 37a-46a) is reported at 132 F.3d 692, and the subsequent clarification of that decision on denial of a petition for rehearing and suggestion of rehearing en banc (Pet. App. 47a-49a) is reported at 144 F.3d 717. The original decision of the district court granting Irwin summary judgment (Pet. App. 50a-62a) is reported at 953 F. Supp. 367.

JURISDICTION

The court of appeals entered its judgment on June 15, 2001. Irwin filed a petition for rehearing and suggestion of rehearing en banc, which the court of appeals denied on August 15, 2001 (Pet. App. 66a-67a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

The full text of the following provisions appears at Pet. App. 68a-139a:

12 U.S.C. § 2607(a), (c).

12 U.S.C. § 2617(a), (b).

24 C.F.R. § 3500.4(a)(1)(ii).

24 C.F.R. § 3500.14(g)(1), (2).

Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to

Mortgage Brokers; Final Rule, 64 Fed. Reg. 10,080 (Mar. 1, 1999).

Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule, 66 Fed. Reg. 53,052 (Oct. 18, 2001).

STATEMENT OF THE CASE

Home mortgage lenders across the country pay countless "yield spread premiums" to mortgage brokers every day of the week, allowing consumers to lower or even eliminate the up-front costs of finding a home mortgage. This case concerns the legality of this commonplace business practice under the Real Estate Settlement Procedures Act of 1974 ("RESPA" or the "Act"), 12 U.S.C. § 2601 *et seq.*

I. THE MORTGAGE BROKERAGE INDUSTRY AND YIELD SPREAD PREMIUMS

Historically, home buyers obtained mortgage loans directly from mortgage lenders, such as local banks or savings and loan associations. These lenders originated mortgage loans through their own retail offices and with their own funds, and then held the loans for their entire term. *See* Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers; Final Rule ("1999 Policy Statement"), 64 Fed. Reg. 10,080, 10,080 (Mar. 1, 1999) (Pet. App. 77a). Starting in the 1980s, independent "mortgage brokers" began offering mortgage loans on a retail basis that were funded and acquired by wholesale lenders (a practice known as "table funding"). *Id.* Today, mortgage brokers originate half of all mortgage loans made in the United States. *Id.* (Pet. App. 78a). Petitioner Irwin, one of the nation's top mortgage lenders, offers home mortgage loans both on a retail basis and on a wholesale basis through a national network of thousands of non-exclusive mortgage brokers.

In addition to providing facilities and goods, such as office space, equipment, staff and the documentation that comprises a mortgage loan, mortgage brokers like those in Irwin's network provide a myriad of services that are necessary to create a loan package for a mortgage lender to fund and acquire. *Id.* at 10,081, 10,085 (Pet. App. 78a-79a, 94a-95a). These services include, among other things, taking information from borrowers and completing applications; analyzing prospective borrowers' income and debt and pre-qualifying borrowers to determine the maximum loan amount they can afford; counseling borrowers about loan products, the lending process, and credit-qualification underwriting issues; collecting and verifying financial information; providing disclosures; obtaining credit reports; ordering legal documents; initiating property inspections and appraisals; preparing loan documents; and participating in closings. *Id.* at 10,085 (Pet. App. 94a-95a). "The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants" as well as with the "different servicing or processing arrangements with wholesale lenders." *Id.* at 10,081. (Pet. App. 78a-79a).

A mortgage broker's compensation for originating and processing a loan may be paid directly by the borrower in up-front fees, indirectly through the acceptance of a higher interest rate in exchange for lender payments to the broker, or by a combination of both. *Id.* at 10,081 (Pet. App. 79a). Lender payments to mortgage brokers thus allow consumers in many instances to obtain loans without paying any direct fees themselves. *Id.* (Pet. App. 80a). Among the most common lender payments relied upon by home buyers to reduce out-of-pocket settlement costs are yield spread premiums, which are payments from lenders calculated in part based on the interest rate of the loan. On a daily basis, lenders send brokers rate sheets listing a range of wholesale loan prices, expressed in relationship to a bench-mark "par"

interest rate. *Id.* For loans below the par rate, lenders charge discount points, while for loans above the par rate, lenders pay yield spread premiums. Thus, depending upon their objectives, position, and cash on hand, borrowers may choose from a spectrum of interest-rate and up-front-cost combinations.

II. STATUTORY AND REGULATORY FRAMEWORK

In 1974, before the rise of the mortgage brokerage industry, Congress enacted RESPA to protect home buyers from "unnecessarily high settlement charges caused by certain abusive practices." 12 U.S.C. § 2601(a). Among other such practices, RESPA, in Section 8(a), prohibits giving or receiving "any fee, kickback, or thing of value pursuant to any agreement or understanding ... that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." *Id.* § 2607(a).[1] This general prohibition against referral fees and kickbacks is modified, however, by Section 8(c) of the Act, which provides that "[n]othing in this section [8] shall be construed as prohibiting ... payment for goods or facilities actually furnished or for services actually performed." *Id.* § 2607(c)(2).

Congress has expressly delegated to the U.S. Department of Housing and Urban Development ("HUD") authority to implement RESPA. *See* 12 U.S.C. § 2617(a) ("The Secretary [of Housing and Urban Development] is authorized to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable

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[1] Real estate "settlement services" include "the origination of a federally related mortgage loan," 12 U.S.C. § 2602(3), and a "federally related" mortgage loan is generally one made by a lender insured or regulated by the federal government, made or assisted by the federal government, to be sold to Fannie Mae, Freddie Mac, or Ginnie Mae, or is made by certain real-estate investors, *id.* § 2602(1)(B).

exemptions for classes of transactions, as may be necessary to achieve the purposes of this Act."). HUD has provided that such "a rule, regulation or interpretation" includes, among other things, any "document that is published in the FEDERAL REGISTER by the Secretary and states that it is an 'interpretation,' 'interpretative rule,' 'commentary,' or a 'statement of policy' for purposes of [§ 2617(a)]." 24 C.F.R. § 3500.4(a)(1)(ii).[2]

HUD has exercised its delegated authority to issue basic regulations implementing RESPA, *see* 24 C.F.R. § 3500 *et seq.*, commonly referred to as "Regulation X," *id.* § 3500.1. Regulation X specifies that while "Section 8 of RESPA permits ... payment for goods or facilities actually furnished or for services actually performed," *id.* § 3500.14(g)(1)(iv), "[i]f the payment ... bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided," *id.* § 3500.14(g)(2).

Acting again pursuant to its congressionally delegated authority to implement RESPA, and in response to congressional concerns, HUD issued a statement of policy in 1999 that set forth a two-part test for determining the legality of payments, including yield spread premiums, to mortgage brokers under the anti-kickback provisions of Section 8 and Regulation X.[3] Under the HUD test, the

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[2] The delineation of which HUD pronouncements are binding is significant to the enforcement of RESPA because the Act provides a safe harbor for "any act done or omitted in good faith in conformity with any rule, regulation, or interpretation" by HUD. 12 U.S.C. § 2617(b).

[3] In reaction to a mounting litigation crisis surrounding yield spread premiums, *see infra* at 22-23, the House Conference Report on the Veterans Affairs and HUD Appropriations Act, 1999 ("1998 Conference Report") emphasized that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations" of Section 8 of RESPA. *See* H.R. Conf. Rep. No. 105-769, at 260 (1998). The 1998 Conference Report directed HUD "to clarify its position" on the legality of lender payments to

threshold question is "whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker." 64 Fed. Reg. at 10,085 (Pet. App. 94a). To facilitate the determination of whether sufficient services were performed by brokers to satisfy this initial prerequisite for legality under Section 8, HUD identifies a typical set of such services and sets out minimal requirements for the number and types of such services that must be performed. *See id.* (Pet. App. 94a-96a).[4]

If the first step is met, the second—and "determinative"—question under the HUD test is whether the total compensation paid to the broker "is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." *Id.* at 10,085-86 (Pet. App. 97a-98a). Under this latter step, "total compensation" encompasses both direct fees (from the borrower) and indirect fees (from the lender), including payments that are based on the "interest rate" of a loan, like yield spread premiums. *Id.* at 10,084, 10,086 (Pet. App. 93a, 100a). As explained below, HUD reaffirmed this test in the Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule,

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brokers under RESPA and to provide "guidance" to "the courts" to reduce the "legal uncertainty" surrounding the practice. *Id.* HUD responded to this directive with the 1999 Policy Statement. 64 Fed. Reg. at 10,080 (Pet. App. 75a).

[4] HUD also identifies the "goods and facilities, such as reports, equipment, and office space," that brokers may provide. 64 Fed. Reg. at 10,081 (Pet. App. 78a); *id.* at 10,085 (Pet. App. 97a) (noting that "goods" include "appraisals, credit reports, and other documents required for a complete loan file" and that "facilities" include "retail or 'store-front' operation").

66 Fed. Reg. 53,052 (Oct. 18, 2001) (Pet. App. 107a-139a) ("2001 Policy Statement").[5]

III. HISTORY OF THIS LITIGATION

In December of 1995, Respondents John and Patricia Culpepper used a mortgage broker, Premiere Mortgage Company, to obtain an FHA home mortgage loan from Irwin (then Inland Mortgage Corporation) in the amount of $77,761 at an interest rate of 7.5%. N.D. Ala. Record, 2SR6-81P-Ex. 1-Ex. X.[6] The Culpeppers paid a $760.50 origination fee to the broker and the broker received the rest of its compensation through a $1,263.61 yield spread premium from Irwin.[7] N.D. Ala. Record, 2SR6-81S-Ex. F, 2SR1-54A-19.

In August of 1997, Respondent Beatrice Hiers, whose loan was unusually complicated due to an earlier Chapter 13 bankruptcy petition she had filed, N.D. Ala. Record, 2SR4-62F-2, obtained an FHA adjustable rate home mortgage loan in the amount of $157,874 from Irwin through a mortgage broker, Homebuyers Mortgage Incorporated. N.D. Ala.

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[5] HUD ensures that consumers are informed of any yield spread premium in their settlement. HUD, for example, requires that yield spread premiums be disclosed to borrowers on a "Good Faith Estimate" at the time of applying for a loan and on a final "HUD-1" settlement statement at or before closing. 24 C.F.R. pt. 3500, App. B, Illus. 13; 64 Fed. Reg. at 10,087 (Pet. App. 103a); *see also* 24 C.F.R. pt. 3500, App. A, Section L (Instructions for Completing HUD-1). In addition, HUD mandates that borrowers receive a settlement costs booklet from HUD explaining the settlement process, 41 Fed. Reg. 23,620 (June 10, 1976), 52 Fed. Reg. 13,566 (Apr. 23, 1987), and describing the sources of broker compensation and their relationship to points and interest rates. 62 Fed. Reg. 31,982 (June 11, 1997).

[6] Citations to the record in the court of appeals are indexed against the record in the district court, as required by Eleventh Circuit Local Rule 28-4.

[7] The origination fee paid to the broker by the Culpeppers would not have covered the broker's overhead for the settlement, let alone provided full compensation for the services rendered. N.D. Ala. Record, 2SR6-81S-Ex. B-39-40.

Record, 2SR1-54A-18, 2SR6-81S-Ex. G. The broker received, among other compensation, $758.64 directly from Hiers, as well as a $4,538.87 yield spread premium from Irwin. In each case, Respondents were able to close on their loans by effectively financing their closing costs over the life of the loan through yield spread premiums, even though they did not have sufficient funds to pay up-front settlement costs (including compensation for the variety of services and goods provided by their brokers). N.D. Ala. Record, 2SR6-81P-Ex. 2-26-27, 2SR4-62F-3-4.

In April 1996 and August 1998, respectively, the Culpeppers and Hiers filed separate class-action lawsuits alleging that Irwin's payment of yield spread premiums violated Section 8 of RESPA.[8] Initially, the district court granted Irwin summary judgment on the Culpeppers' individual claims. Pet. App. 60a. The court of appeals reversed, holding that the yield spread premium was a referral fee under § 2607(a). Pet. App. 43a. The court concluded that the payment did not fall within the "exception[]" listed in § 2607(c)(2) for "payment for goods or facilities actually furnished or for services actually performed." *Id.* This was so, according to the court, because "[n]o evidence suggest[ed] that [the origination fee] was not intended by both [the broker] and the Culpeppers to compensate [the broker] fully for the work it did for the Culpeppers," and because the yield spread premium was based in part on the interest rate and "not tied to the quantity or quality of the [broker's] services." Pet. App. 43a-44a. The court of appeals held, moreover, that the yield spread premium could be found illegal under RESPA without regard to whether the fees received by the broker exceeded the fair market value of the services actually rendered. Pet. App. 45a.

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[8] The jurisdiction of the district court was invoked under 12 U.S.C. § 2607(d)(2), (5) and 28 U.S.C. § 1331.

On remand, the district court consolidated the Culpeppers' and Hiers' actions, and certified a nationwide class under Federal Rule of Civil Procedure 23(b)(3). The class included all persons who obtained an FHA loan funded by Irwin during the period April 11, 1995 to June 22, 1999, where the broker was paid an origination fee of 1% or greater and received a yield spread premium paid by Irwin. Pet. App. 17a, 25a. The district court held that class certification was appropriate because the claims of the putative class turned "largely, almost exclusively, on [one] issue": the evidence that the yield spread premiums Irwin paid were "unconnected to anything but the difference between the par rate and the interest rate at which the mortgage was made." Pet. App. 26a.

The court of appeals granted Irwin's Federal Rule of Civil Procedure 23(f) petition for interlocutory review and affirmed. Pet. App. 3a, 14a-15a.[9] The court of appeals began its analysis with the proposition that the "ultimate issue" of class certification under Rule 23(b)(3)'s requirement that "'questions of law or fact common to the members of the class predominate over any questions affecting only individual members'" required it "to settle on a rule of liability" under Section 8 of RESPA. Pet. App. 6a (quoting

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[9] The court of appeals also granted Rule 23(f) petitions in three similar cases challenging yield spread premium payments under Section 8 of RESPA, *Heimmermann v. First Union Mortgage Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999) (class certification granted), *petition to appeal granted*, No. 99-14066 (11th Cir. Oct. 19, 1999); *McBride v. ReliaStar Mortgage Corp.*, No. 1:98-CV-215-TWT (N.D. Ga. Apr. 29, 1999) (class certification denied), *petition to appeal granted*, No. 99-12110 (11th Cir. July 8, 1999); *Hirsch v. BankAmerica Corp.*, No. 1:98-CV-1031-ODE (N.D. Ga. Apr. 20, 1999) (class certification denied), *petition to appeal granted*, No. 0011837-TT (11th Cir. June 9, 1999). The court of appeals consolidated these cases with the case below for briefing and oral argument, but has only ruled on this case. As discussed below, the court of appeals has issued orders in the three pending cases requesting supplemental briefing on the 2001 Policy Statement. Pet. App. 140a-45a.

Fed. R. Civ. P. 23(b)(3)). The court explained that this was so because "[w]hether transaction-specific evidence is necessary or relevant ... depends on the rule of liability." *Id.* The court of appeals accordingly held that the "crux of [the] appeal," Pet. App. 5a, was the proper interpretation of HUD's two-part test governing proof of Section 8 violations, because the 1999 Policy Statement was "imbue[d] with the force of a regulation" under 24 C.F.R. § 3500.4(a)(1)(ii). *Id.*[10]

The court, however, found the 1999 Policy Statement "ambiguous" with respect to the meaning of the phrase "for compensation paid" in the threshold inquiry in the HUD test concerning "'whether goods or facilities were actually furnished or services were actually performed for the compensation paid.'" Pet. App. 6a, 8a (quoting 64 Fed. Reg. at 10,084). To the court, the phrase could mean, as Respondents argued, that any payment must be "specifically for [the] services" provided by a broker (*i.e.*, a direct link between the specific element of compensation and the services provided). Pet. App. 7a. Alternatively, as Petitioner maintained, the phrase could simply require that a requisite quantity and quality of services actually be performed before turning to an analysis of the relationship between total broker compensation from all sources and the value of the broker's services. Pet. App. 8a-9a. Thus framed, the court "turn[ed] to determining the rule of liability prescribed by the HUD [1999 Policy Statement]." Pet. App. 8a.

The court of appeals "agree[d] with [Respondents'] view of the rule of liability" that the threshold step of the HUD test requires a broker to have performed the services

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[10] Irwin on appeal generally did not challenge the sufficiency of the threshold requirements for class certification under Rule 23(a), with the exception of a challenge to Respondent Hiers' adequacy to act as class representative, an issue the court of appeals found unnecessary to address. Pet. App. 14a n.15.

provided as part of a direct "services-for-money exchange." *Id.* For the court, this interpretation of the HUD test best fit the dictionary definition of the word "for," Pet. App. 9a (quoting *Webster's Third International Dictionary* 886 (unabridged ed. 1981)), avoided any tension between the HUD test and the language of RESPA Section 8(c), Pet. App. 10a, and prevented the HUD test from creating an inconsistency between Sections 8(a) and 8(c) of the Act, *id.* The court also rejected Irwin's alternative argument, arising from the standard set forth on the original appeal of Irwin's summary judgment motion, that class certification is inappropriate because liability under RESPA requires an analysis of the subjective intent of the broker and borrower about the degree to which any yield spread premium constitutes payment for services rendered. Pet. App. 13a-14a.

Accepting Respondents' view that any yield spread premium payment not tied at the outset to a specific service is, by definition under the threshold step of the HUD test, an illegal referral fee, the court concluded that class certification was appropriate. Pet. App. 14a. Class members did not, in the court's view, need to demonstrate the lack of a reasonable relationship between total broker compensation and services in each transaction, but could instead rely on common proof that Irwin had standard agreements with brokers to calculate and pay yield spread premiums with reference to interest rates. Pet. App. 13a-14a. As a result, the court concluded that a yield spread premium could represent an illegal kickback even if the amount of the fee did not exceed the fair market value of the services that were actually performed by the broker.

IV. THE HUD 2001 POLICY STATEMENT

On October 18, 2001, only a little over two months after the court of appeals denied Irwin's petition for rehearing and suggestion of rehearing en banc, and in direct response to

the opinion below, HUD issued the 2001 Policy Statement. Taking the extraordinary step of directly addressing the decision of the court of appeals in this case, HUD indicated that it "disagree[d] with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy." 66 Fed. Reg. at 53,054-55 (Pet. App. 119a). Acting again under its congressionally delegated authority to implement RESPA, HUD made clear that contrary to the court of appeals' central thesis, the "amount of the [yield spread premium] is not, under the HUD test, scrutinized separately and apart from total broker compensation." *Id.* at 53,053 (Pet. App. 111a).

The 2001 Policy Statement emphasized that:

> [N]either Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion [of the court of appeals] that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.

Id. at 53,055 (Pet. App. 120a). HUD has left no doubt that "[t]he legality of any yield spread premium can only be evaluated in the context of the test HUD established and the *specific factual circumstances* applicable to *each transaction* in which a yield spread premium is used." *Id.* at 53,054 (Pet. App. 117a) (emphasis added).[11]

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[11] Following HUD's promulgation of the 2001 Policy Statement, the district court ordered the parties to file supplemental briefs "analyzing the import" of both the 2001 Policy Statement and an order granting summary judgment for the defendant lender in another case challenging yield spread premiums under Section 8 of RESPA, *Bjustrom v. Trust One Mortgage*, No. C00-1166P (W.D. Wash. Oct. 26, 2001) (relying on the 2001 Policy Statement). Pet. App. 64a.

REASONS FOR GRANTING THE PETITION

In affirming class certification on the theory that yield spread premiums may be found illegal under RESPA based solely on the fact that such payments are calculated based on interest rates, the court of appeals decided an issue of national importance that affects home buyers, mortgage lenders and mortgage brokers throughout the country. In contravention of long-standing HUD policy, the court below effectively found that yield spread premiums were *per se* illegal, a holding that threatened to eliminate the practice entirely. Recognizing the immediate and widespread impact of this decision, HUD stepped in rapidly to "eliminate any ambiguity" that the court of appeals had created in fundamentally misinterpreting HUD's 1999 Policy Statement, and to reiterate the benefits to consumers that yield spread premiums provide. 66 Fed. Reg. at 53,052 (Pet. App. 107a-08a). The decision of the court of appeals, however, still stands.

Given the clarity of HUD's rejection of the decision below and the Eleventh Circuit's recognition that the HUD test controls the inquiry on class certification, Irwin respectfully requests that the Court grant this petition, vacate the judgment below, and remand for reconsideration in light of HUD's intervening 2001 Policy Statement. *See Lawrence v. Chater*, 516 U.S. 163, 166-67, 172 (1996) (per curiam) (GVR in light of a new interpretation of a federal statute by the agency charged with its implementation); *Schmidt v. Espy*, 513 U.S. 801, 801 (1994) (GVR in light of an administrative reinterpretation of a federal statute). In analogous circumstances, the Eleventh Circuit has "welcome[d]" the "opportunity [provided by a GVR] to revisit" a decision in light of intervening developments. *Richardson v. Reno*, 175 F.3d 898, 899 (11th Cir. 1999). That opportunity should be afforded here as well. Alternatively, if the Court determines that a GVR does not represent the most appropriate resolution of this petition, this case

warrants plenary review to resolve conclusively the test for liability under RESPA for the payment of yield spread premiums, and the impropriety of granting class certification under the correct liability standard. These are issues of national importance that have divided the lower courts.

I. THE ELEVENTH CIRCUIT SHOULD BE GIVEN THE OPPORTUNITY TO RECONSIDER ITS DECISION IN LIGHT OF HUD'S INTERVENING CLARIFICATION OF THE CONTROLLING TEST FOR LIABILITY UNDER SECTION 8 OF RESPA

A. HUD's Explicit Disavowal of the Court of Appeals' Interpretation of HUD's Test Warrants a Remand for Further Consideration

Noting that "the GVR order can improve the fairness and accuracy of judicial outcomes while at the same time serving as a cautious and deferential alternative to summary reversal," 516 U.S. at 168, the Court in *Lawrence* set forth the basic standard for the grant of a GVR order. There, the Court stated that where "intervening developments" reveal a "reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration, and where it appears that such a redetermination may determine the ultimate outcome of the litigation," *id.* at 167, a GVR order may be appropriate. Whether the Court grants the order ultimately turns on the equities of the case, such as whether the intervening development is part of an unfair or manipulative litigation strategy or whether the delay and cost of a remand outweigh the potential benefits of further consideration below. *Id.* at 167-68.

This petition meets the *Lawrence* standard in all respects. To begin with, the 2001 Policy Statement, which is entitled to no less deference than the court of appeals paid to the 1999 Policy Statement on which it based its decision, is

an intervening development that clearly reveals at least a "reasonable probability," if not a certainty, that the decision below rests on a premise that can no longer be sustained. Taking issue with the court of appeals' conclusion that liability under the 1999 Policy Statement "could be established under the first part of the HUD test alone," 66 Fed. Reg. at 53,054 (Pet. App. 119a), HUD has now made clear that "the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a [yield spread premium]." *Id.* at 53,055 (Pet. App. 119a). And, directly contrary to the central proposition underlying the decision below—that the first step of the HUD test requires a specific linkage between any yield spread premium paid and a specific service performed—the 2001 Policy Statement is unambiguous that "[w]here a lender payment to a mortgage broker comprises a portion of total broker compensation, the amount of the payment is not, under the HUD test, scrutinized separately and apart from total broker compensation." *Id.* at 53,053 (Pet. App. 111a).

In response to the court of appeals' assertion that yield spread premiums may be considered illegal referral fees based solely upon the general terms and conditions under which a lender makes a payment to a broker, HUD states that:

> [N]either Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.

Id. at 53,055 (Pet. App. 120a). Thus, "in order to discern whether a yield spread premium was *for* goods, facilities or

services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both." *Id.* (Pet. App. 119a-20a) (emphasis added). In short, "[w]hether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved." *Id.* at 53,055 (Pet. App. 120a).

Although the court of appeals did not reach the second step of the HUD test, HUD clarified in the 2001 Policy Statement that it is necessary at that step to look at each transaction to determine whether the broker's "total compensation" (from the borrower and from the lender) is "reasonably related to the total set of goods or facilities actually furnished or services performed" by comparing the total compensation received by other brokers in similar loan transactions in similar markets. *Id.* (Pet. App. 121a-23a). Just as with the first step, the second step of the HUD test requires a case-by-case examination of the facts and circumstances of each transaction.

HUD has left no doubt that "[t]he legality of any yield spread premium can only be evaluated in the context of the test HUD established and the *specific factual circumstances* applicable to *each transaction* in which a yield spread premium is used." *Id.* at 53,054 (Pet. App. 117a) (emphasis added). HUD's view, moreover, comports entirely with RESPA's mandate that brokers and other providers of settlement services are entitled to "payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c)(2). The holding of the court of appeals, by contrast, would limit broker compensation to up-front fees paid by borrowers, which, as the terms of the Culpeppers' settlement demonstrate, may not even allow the

broker to break even. *See supra* at 7 n.7. The 2001 Policy Statement thus not only raises a "reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration," *Lawrence*, 516 U.S. at 167, but also demonstrates that the court below erred fundamentally in its interpretation of the HUD test, and, as consequence, in affirming the grant of class certification.[12]

Next, remand to the court of appeals at this stage is warranted under *Lawrence* because a redetermination of the "rule of liability" would likely determine the ultimate outcome of the litigation, as well as require decertification of the class. First, the court below repeatedly confirmed that the propriety of certification turned on establishing the "rule of liability" under HUD's interpretation of RESPA.[13] Pet. App. 6a, 8a. Indeed, Respondents moved for summary judgment in the district court based on the rule of liability established by the court of appeals in this decision, and the district court has acknowledged that "the 2001 Policy

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[12] The 2001 Policy Statement also reiterates HUD's long-standing and oft-repeated conclusion that yield spread premiums are not *per se* illegal, as the court of appeals effectively held. 66 Fed. Reg. at 53,054 (Pet. App. 117a). HUD traced its recognition of the validity and utility of yield spread premiums to a 1989 final rule concerning "Deregulation of Mortgagor Income Requirements," *id.* (Pet. App. 116a) (citing 54 Fed. Reg. 38,646 (Sept. 20, 1989) (justifying the retention of limits on loan origination fees by noting that shortfalls in the cost of loan origination services may be recovered by charging higher interest rates)) and to Regulation X, *id.* (citing Illustrations of Requirements of RESPA, Fact Situations 5 and 13 in Appendix B to 24 C.F.R. pt. 3500 and Instructions to Appendix A to 24 C.F.R. pt. 3500 for Completing HUD-1 and HUD 1A Settlement Statements).

[13] Although the court of appeals somewhat parenthetically stated that the question "whether Irwin's yield spread premiums are, or could be, § 8 kickbacks is not relevant to this appeal, which is about the propriety of class certification," Pet. App. 5a n.9, the court then decided the class certification issue entirely as a function of the appropriate rule of liability under HUD's test. *See* Pet. App. 14a.

Statement clearly indicates that it would abrogate the Eleventh Circuit's holdings in [the case below] with regard to both the substantive rules of liability under RESPA § 8 and the propriety of class certification of such claims generally." Pet. App. 64a. It is not clear, however, whether the district court will conclude that it has the latitude to contravene the court of appeals' decision based on the 2001 Policy Statement, or will consider itself bound by the opinion below until the court of appeals itself has had the opportunity to revisit its holding.[14]

The 2001 Policy Statement's definitive refutation of the court of appeals' interpretation of the HUD test for liability under Section 8 of RESPA also warrants decertification of the class. Class certification is not an ancillary issue. It instead represents the type of central issue that warrants reconsideration when intervening legal developments call a court of appeals' decision into question. Indeed, this Court has issued GVR orders in the context of class certification in the past. *See, e.g., Flanagan v. Ahearn*, 521 U.S. 1114, 1114 (1997) (GVR in light of *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591 (1997)); *Eckerd Drugs, Inc. v. Brown*, 457 U.S. 1128, 1128 (1982) (GVR in light of *General Tel. Co. of Southwest v. Falcon*, 457 U.S. 147 (1982)).

Courts of appeals have recognized that class certification decisions can have a dramatic impact on the outcome of litigation in situations where—as here—defendants are confronted with the specter of potentially crippling liability. *See, e.g., Szabo v. Bridgeport Machs., Inc.*, 249 F.3d 672, 675 (7th Cir. 2001) (class certification that turns a "$200,000 dispute" into a "$200 million dispute," "puts a bet-your-company decision to [defendant]'s managers and may induce

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[14] In its order directing the parties to brief the import of the 2001 Policy Statement, the district court urged the parties to focus on "the potential applicability of the law-of-the-case doctrine and whether the 2001 Policy Statement is due deference under [*Chevron*]." Pet. App. 64a.

a substantial settlement even if the [plaintiff]s' position is weak."), *cert. denied*, 70 U.S.L.W. 3267 (2001).[15] Class certification is thus at the core of the issues that will determine the outcome of this case.

Finally, under *Lawrence*, the balance of the equities clearly militates in favor of a GVR in this case. If the court of appeals' test were to stand, HUD's 2001 Policy Statement would have provided the "clarification and certainty" HUD intended to all "lenders, brokers and consumers," 66 Fed. Reg. at 53,053 (Pet. App. 112a), except the very lender whose actions gave rise to the need for the HUD statement. HUD has repeatedly emphasized that yield spread premiums, which the court of appeals all but declared *per se* illegal, provide important benefits to consumers. "One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs," according to HUD, "is the up front cash needed to obtain a mortgage." *Id.* (Pet. App. 115a). Yield spread premiums, however, "can be a useful means to pay some or all of a borrower's settlement costs," thus "foster[ing] homeownership." *Id.* at 53,054 (Pet. App. 116a). Until the HUD 2001 Policy Statement is recognized in the Eleventh Circuit, however,

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[15] The fact that the certification of a plaintiff class in certain circumstances can put tremendous pressure on defendants is reflected in the standards that courts of appeals have adopted in guiding the grant of interlocutory appeal of class certification under Rule 23(f). *See, e.g., Blair v. Equifax Check Servs., Inc.*, 181 F.3d 832, 834 (7th Cir. 1999) (noting that an appeal under Rule 23(f) may be warranted because the "grant of class status can put considerable pressure on the defendant to settle, even when the plaintiff's probability of success on the merits is slight") (citing *In Re Rhone-Poulenc Rorer Inc.*, 51 F.3d 1293 (7th Cir. 1995)); *Prado-Steiman v. Bush*, 221 F.3d 1266, 1274 (11th Cir. 2000) (Rule 23(f) appeal may be appropriate because grant of class status can "raise[] the cost and stakes of the litigation so substantially that a rational defendant would feel irresistible pressure to settle"); *see also* Fed. R. Civ. P. 23(f) advisory committee's notes ("An order granting certification ... may force a defendant to settle rather than incur the costs of defending a class action and run the risk of potentially ruinous liability.").

the validity of the practice of paying yield spread premiums remains in doubt.

Interests of efficiency are also fostered by a remand. The court of appeals will necessarily have to address the impact of the 2001 Policy Statement on its prior interpretation in this case as well as many others that remain pending. Over forty Section 8 yield spread premium class action cases are currently being litigated before various district courts in the Eleventh Circuit or are pending before the Eleventh Circuit on appeal. Indeed, signaling its clear interest in considering the impact of the 2001 Policy Statement, the Eleventh Circuit has ordered briefing in the three Section 8 yield spread premium cases it is still considering. *See supra* at 9 n.9. It would be far less costly and entail far less delay for this Court to take the "cautious and deferential" step of granting a GVR order.[16]

B. There is a Compelling Basis for the Court of Appeals to Conclude on Remand that HUD's Intervening Policy Statement is Binding

Although Respondents will likely contend that HUD's 2001 Policy Statement is not binding, any such assertion should not forestall a remand. This Court need not determine the precise level of deference the 2001 Policy Statement is due in order to grant a GVR, because "if an agency interpretation is reasonably probably entitled to

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[16] Beyond the merits of this petition, moreover, giving the court below the opportunity to reconsider its decision in light of HUD's intervening clarification has the potential to forestall a conflict among the circuit courts, as the issues decided by the Eleventh Circuit prior to the 2001 Policy Statement are pending before both the Eighth Circuit, *see Glover v. Standard Fed. & Heartland*, No. 00-8018, and the Ninth Circuit, *see Schuetz v. Banc One Mortgage Corp.*, No. 01-16206, and are being litigated in district courts in almost every other circuit. The longer the Eleventh Circuit's pre-2001 Policy Statement decision erroneously interpreting the HUD test remains, the greater the likelihood becomes that other courts of appeals will decide this issue in line with the 2001 Policy Statement and create a split.

deference and potentially determinative, [the Court] may GVR in light of it." *Lawrence*, 516 U.S. at 172. There can be little doubt, moreover, that the 2001 Policy Statement is entitled to binding deference under *Chevron U. S. A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984), and not simply *Skidmore* deference under the analysis set forth in *United States v. Mead Corp.*, – U.S. –, 121 S. Ct. 2164, 2172 (2001).

The court of appeals determined that RESPA was ambiguous as to whether yield spread premiums are illegal under Section 8 and Congress expressly delegated to HUD specific authority to resolve any such ambiguity. *See* 12 U.S.C. § 2617(a).[17] Indeed, that is precisely why the court of appeals relied on the HUD test below. And the 2001 Policy Statement now represents HUD's binding and definitive clarification of that test. HUD expressly invoked its authority to issue binding interpretations of RESPA under § 2617(a) by issuing a "statement of policy" published in the Federal Register, as authorized by 24 C.F.R. § 3500.4(a)(1)(ii). In promulgating the 2001 Policy Statement, HUD was careful to invoke the formality required by § 3500.4(a)(1)(ii). *See* 66 Fed. Reg. at 53,052 (Pet. App. 109a) (stating that HUD was "issuing [the] Statement of Policy in accordance with 5 U.S.C. 552 as a formal pronouncement of its interpretation of relevant statutory and regulatory provisions"). Finally, the 2001 Policy Statement is not only rational, but eminently reasonable. It protects consumers from "unnecessarily high" settlement costs, 12 U.S.C. § 2601(a), by preventing naked

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[17] To the degree, of course, that the 2001 Policy Statement is simply a clarification of HUD's own earlier 1999 Policy Statement, which the court of appeals held to be "ambiguous," Pet. App. 6a, and the underlying regulatory provisions the earlier policy statement elucidated, it would be entitled to binding deference on that ground alone. *See Auer v. Robbins*, 519 U.S. 452, 461 (1997) (agency's interpretation of its own regulation is "controlling" unless plainly erroneous or inconsistent with the regulation).

referrals and kickbacks (*i.e.*, fees to parties who do "nothing," *Mercado v. Calumet Fed. Sav. & Loan Ass'n*, 763 F.2d 269, 271 (7th Cir. 1985), other than steer business to lenders), while at the same time preserving the significant benefits to consumers that HUD has recognized yield spread premiums provide.[18]

II. IN THE ALTERNATIVE, THIS CASE IS APPROPRIATE FOR PLENARY REVIEW TO CORRECT THE ELEVENTH CIRCUIT'S ERRONEOUS INTERPRETATION OF THE APPLICABLE TEST FOR LIABILITY UNDER SECTION 8 OF RESPA

If, for any reason, the Court determines that a GVR order does not represent the most appropriate resolution of this petition, it should grant plenary review. The decision below resolves an issue of exceptional importance that has divided lower courts and warrants the Court's attention at this time.

Over the past decade, plaintiffs have filed nearly two hundred class actions nationwide challenging yield spread premiums under Section 8 of RESPA. The decision below has only accelerated the pace of litigation, with more than thirty-five additional cases filed since it was handed down and mass solicitation of potential claimants underway for

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[18] Even if not entitled to *Chevron* deference, the 2001 Policy Statement would be entitled to a high level of deference under *Mead*, 121 S. Ct. at 2171-72, 2175-76. HUD has unparalleled expertise with RESPA's complex statutory and regulatory scheme as well as with the home mortgage industry; HUD used a high degree of care in formulating both the test set forth in the 1999 Policy Statement and the clarification of that test in the 2001 Policy Statement and formally published its interpretation in the Federal Register. Finally, HUD's position is entirely consistent with its previous recognition of the validity of yield spread premiums and its recognition that yield spread premiums benefit consumers. *See* 54 Fed. Reg. 38,646 (Sept. 20, 1989); 62 Fed. Reg. 53,912, 53,920-21 (Oct. 16, 1997); 64 Fed. Reg. at 10,081 (Pet. App. 80a). Again, the Court need not resolve this issue in order to issue a GVR order. *Lawrence*, 516 U.S. at 172.

additional cases (a process spurred on by the availability of treble damages and attorney's fees under RESPA). The impact of the decision below on the mortgage banking industry, moreover, cannot be overstated. Millions of Americans obtain more than a trillion dollars in mortgage loans annually, half of which are originated by mortgage brokers, resulting in tens of billions of dollars in lender yield spread premium payments to mortgage brokers each year.[19] The potential class-wide exposure in any given case may range well into the billions of dollars.

The "legal uncertainty" engendered by the litigation crisis surrounding yield spread premiums prompted the House Conference Report on the Veterans Affairs and HUD Appropriations Act, 1999 to direct HUD "to clarify its position" on the issue. *See* H.R. Conf. Rep. No. 105-769, at 260 (1998). HUD responded with the 1999 Policy Statement, attempting to resolve the litigation crisis and bring certainty to consumers, lenders and brokers. The opinion of the court of appeals in this case amply illustrates, however, that the 1999 Policy Statement did not have its intended effect. HUD was required to intervene yet again by issuing its 2001 Policy Statement. Even though the 2001 Policy Statement leaves no ambiguity about the proper test for determining the legality of yield spread premiums, plaintiffs' class action counsel across the country have already begun to challenge that interpretation. A definitive ruling from this Court would represent the only way to end this decade-long battle to destroy a vital segment of the home-mortgage industry.

Finally, while the opinion below does not conflict with any other court of appeals decision, it is in conflict with a multitude of district court decisions. In all, forty-eight district court decisions (thirty-four outside the Eleventh

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19 In one recent year alone, yield spread premiums were paid in connection with over $700 billion in loan originations. *See* Lew Sichelman, *YSPs 'Crucial' for the Industry*, National Mortgage News, Apr. 28, 1997, at 25 (discussing 1996 data).

Circuit) have interpreted RESPA Section 8 to preclude class certification in analogous yield spread premium cases, and in nine cases, district courts have interpreted Section 8 to allow for class treatment (six of which were in the Northern District of Alabama, including the decision affirmed below). While Petitioner submits that a GVR order is appropriate, plenary review by this Court would forestall a growing conflict of authority and bring needed and definitive resolution to the litigation crisis currently facing the home-mortgage industry.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

MAUREEN E. MAHONEY
NESTOR M. DAVIDSON
LATHAM & WATKINS
555 Eleventh Street, N.W.
SUITE 1000
WASHINGTON, D.C. 20004
(202) 637-2200

*ALAN H. MACLIN
ROBERT J. PRATTE
BRIGGS AND MORGAN
2400 IDS CENTER
80 SOUTH EIGHTH STREET
MINNEAPOLIS, MN 55402
(612) 334-8400

*Counsel of Record

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT.

No. 99-13725.

John Robert Culpepper, Patricia Starnes Culpepper, On Behalf Of Themselves And All Others Similarly Situated, Plaintiffs-Appellees,

v.

Irwin Mortgage Corporation, f.k.a Inland Mortgage Corporation, Defendant-Appellant.

Beatrice N. Hiers, individually and as a representative of a class of similarly situated persons, Plaintiff-Appellee,

v.

Irwin Mortgage Corporation, f.k.a. Inland Mortgage Corporation, Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Alabama

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June 15, 2001.

Before EDMONDSON, COX and GIBSON*, Circuit Judges.

OPINION

COX, Circuit Judge:

This action under § 8 of the Real Estate Settlement Practices Act[1] is now on its second visit to our court. The plaintiffs, who have home mortgage loans from Irwin Mortgage Corporation, claim that certain payments, called "yield spread premiums," that Irwin made to the mortgage brokers who handled the plaintiffs' loan applications are illegal kickbacks or referral fees under § 8. The district court initially granted Irwin summary judgment, and on the action's first trip to this court, we reversed. *Culpepper v. Inland Mortgage Corp. (Culpepper I)*, 132 F.3d 692, 694 (11th Cir. 1998).[2] (The court then explained in a published order denying rehearing (*Culpepper II*) that its opinion—which merely reversed summary judgment—should of course not be read to require summary judgment in the *plaintiffs'* favor.[3]) The panel remanded for further proceedings.

One of those proceedings was a motion for class certification, which the district court granted. The plaintiff class now comprises

> [a]ll persons who, from April 11, 1995, until this class is certified, [June 22, 1999], inclusive, obtained an FHA mortgage loan that was funded by Irwin Mortgage

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* Honorable John R. Gibson, U.S. Circuit Judge for the Eighth Circuit, sitting by designation.

1 12 U.S.C. § 2607.

2 Inland Mortgage Corporation has become Irwin Mortgage Corporation since the first appeal.

3 *Culpepper v. Inland Mortgage Corp. (Culpepper II)*, 144 F.3d 717, 717-18 (11th Cir. 1998).

Corporation wherein the broker was paid a loan origination fee of 1% or more and wherein Irwin paid a "yield spread premium" to a mortgage broker. [4]

Irwin was permitted to appeal this class certification under Fed.R.Civ.P. 23(f). Reviewing the district court's ruling for abuse of discretion only,[5] we affirm.

Background

The "yield spread premiums" at issue in this case,[6] as the panel explained more fully in *Culpepper I*,[7] are payments from Irwin to its mortgage brokers that the written agreement between them contemplates, but does not define.[8] Each business day, Irwin distributes a rate sheet to its brokers, listing the terms of the loans Irwin is offering that day. The loans' interest rates are set with reference to a "par rate." If the broker originates a loan at a below-par rate, it gets no compensation from Irwin. On the other hand, originating a loan at an above-par rate garners the broker a yield spread premium, whose amount is determined by a formula that includes the amount of the loan and the difference between the loan rate and the par rate. The formula does not take into account the amount of work the broker actually performed in originating the loan

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4 (R.1-59 at 2.)

5 *Heaven v. Trust Co. Bank*, 118 F.3d 735, 737 (11th Cir. 1997).

6 We do not pretend to define, or address in this opinion, all of the payments that lenders and brokers may refer to as "yield spread premiums."

7 *See Culpepper I*, 132 F.3d at 694.

8 The form "Revised Loan Broker Agreement" between Irwin and both the brokers involved in this case makes only one explicit mention of yield spread premiums, in a section setting the price for repurchase of a loan by the broker back from Irwin. That price, the agreement provides, includes "[a]ny yield spread premium ... or other amounts previously paid by Irwin to Broker for the Loan." (1st Supp. R.-Pls.' Evid. Submiss. Supp. Mot. Class. Cert. Ex. D. § 10.)

or how much the borrower paid in fees for the broker's services. *See Culpepper I*, 132 F.3d at 694.

Section 8(a) of the Real Estate Settlement Practices Act (RESPA) prohibits both the giving and acceptance of "any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service ... shall be referred to any person." 12 U.S.C. § 2607(a). (Lending is clearly a "business incident to or a part of a real estate settlement service." *See* 12 U.S.C. § 2602(3).) Subsection (c) then qualifies subsection (a)'s blanket prohibition by explicitly sheltering from liability "the payment of a fee ... by a lender to its duly appointed agent for services actually performed in the making of a loan." *Id.* § 2607(c)(1)(C). The Senate report accompanying RESPA explains that subsection (c) is there to "specifically set[ ] forth the types of legitimate payments that would not be proscribed by the section." S.Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6552.

Presented with this § 8 challenge to yield spread premiums, the *Culpepper I* panel read § 8(a) to prescribe a three-part test for prohibited payments. A payment is prohibited if "(1) a payment of a thing of value is (2) made pursuant to an agreement to refer settlement business and (3) a referral actually occurs." *Culpepper I*, 132 F.3d at 696. The undisputed facts in this action are that Irwin offered to pay (and did pay) a yield spread premium to the broker here, under their agreement, which led the broker to choose Irwin. Those facts satisfy § 8(a), the panel concluded. That § 8(a) conclusion remains unchallenged on this appeal.

The court went on to reject Irwin's argument that yield spread premiums are nonetheless sheltered by § 8(c). Irwin's payments to brokers, the court concluded, resist

characterization as payment for services.[9] Nothing in their agreement, for instance, suggests that the amount paid is in any way dependent on the services provided; most significantly, nothing in the record suggests that the broker renders less service in originating a below-par loan than it does for an above-par loan, or that Irwin ever inquires into how much work the broker actually did. Rather, the payment rests solely on the value of the referral. Yield spread premiums, the panel concluded, are thus prohibited referral fees—or at least a jury could so find. *Id.* at 696-97; *Culpepper II*, 144 F.3d at 718.

Following this court's opinion in *Culpepper I*, Congress issued a conference report demanding that HUD "clarify" its position concerning the legality of yield spread premiums. HUD responded with a policy statement, which 24 C.F.R. § 3500.4(a)(1)(ii) imbues with the force of a regulation,[10] that yield spread premiums are not illegal per se, but can nonetheless be illegal. HUD tests their legality in two steps. The first question—whose interpretation is the crux of this appeal—is "whether goods or facilities were actually furnished or services were actually performed for the compensation paid." Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10080, 10084 (Dep't of Hous. & Urban Dev. March 1, 1999)[hereinafter HUD Statement]. The fact that "services have been actually performed by the mortgage broker does not by itself," HUD explains, "make the payment legal." *Id.*

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[9] Irwin devotes a surprising amount of its brief to challenging this conclusion about the merits. The question of whether Irwin's yield spread premiums are, or could be, § 8 kickbacks is not relevant to this appeal, which is about the propriety of class certification.

[10] The Secretary of Housing and Urban Development has power under 12 U.S.C. § 2617 to issue interpretive regulations, and has done so. *See* 24 C.F.R. pt. 3500. None of those regulations add anything to the statute that is pertinent to the issues presented in this case.

Rather, an answer of "yes" to the first question leads to the second question, which is "whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." *Id.* The remainder of the Statement describes in some detail the application of this rule. The Statement is ambiguous, however, as to the core of the class-certification dispute here, permitting the parties to read it in importantly different ways, as we next explain.

Contentions of the Parties

The parties agree that deciding whether class certification is appropriate—the ultimate issue in this appeal—requires us, in the end, to settle on a rule of liability under § 8(a) and (c). The reason is that Irwin attacks only the district court's conclusion that "the questions of law or fact common to the members of the class predominate over any questions affecting only individual members," and that the class is thus certifiable under Fed.R.Civ.P. 23(b)(3). Irwin contends that evidence specific to each plaintiff's loan transaction will predominate at trial, making class treatment improper. Whether transaction-specific evidence is necessary or relevant, of course, depends on the rule of liability. *See* 2 Weinstein's Federal Evidence § 401.04[3][b] (Joseph M. McLaughlin ed., 2d ed. 1997). Hence we arrive at determining the rule of liability.

The centerpiece of Irwin's argument on this point is that the HUD Statement overrules *Culpepper I*'s interpretation of § 8(c). According to Irwin, the Statement provides a two-step "reasonableness test": (1) whether *any* services were performed by the broker, and (2) whether the yield spread premium and the fees the borrower pays the broker add up to reasonable compensation for the broker's work. In essence, Irwin says that any payment it makes to any potential referrer is all right, as long as the payment, whatever its reason, would have been reasonable

compensation for services, had it been compensation for services.[11] *Culpepper I*, Irwin argues, thus wrongly demands evidence that Irwin pays brokers yield spread premiums in return for service and not merely to reward brokers for high-interest loan referrals. HUD's rule, Irwin continues, demands that legality be tested transaction by transaction, since the amount of work done by the broker (investigation, paperwork, counseling, and so forth) varies from loan to loan.

As a fallback position, Irwin argues that even *Culpepper I*'s test for legality under § 8(c)—which asks whether the lender and the broker exchanged money for services, not just whether the broker's compensation was reasonable—requires us to determine whether the borrower and the broker subjectively intended, in each loan transaction, for the yield spread premium to be Irwin's payment for the broker's services.[12] That question, Irwin says, can only be answered with testimony about each loan transaction from its parties.

The plaintiffs counter that *Culpepper I* and the HUD Statement are consistent. This is so, they say, because the first question in HUD's two-step analysis includes not just whether the broker really worked, but also whether Irwin paid the money specifically for those services and not for the loan referral. HUD's first question would thus be, in substance, no more than a re-articulation of *Culpepper I*'s reason for rejecting Irwin's argument that yield spread premiums, even if otherwise prohibited by § 8(a), are

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[11] This is roughly how many of the district courts that have denied class certification in yield spread premium cases have described the rule. *See, e.g., Schmitz v. Aegis Mortgage Corp.*, 48 F.Supp.2d 877, 882 (D.Minn. 1999); *Levine v. N. Am. Mortgage Co.*, 188 F.R.D. 320, 327 (D.Minn. 1999); *Taylor v. Flagstar Bank*, 181 F.R.D. 509, 521 (M.D.Ala. 1998).

[12] This view also has some district court support. *See Chandler v. Washtenaw Mortgage Co.*, No. 94-A-1418-N, ms. op. at 3 (M.D.Ala. July 29, 1998).

protected compensation for services under § 8(c). Whether we use the first question in the HUD test or adhere to *Culpepper I*'s reasoning, the plaintiffs say, the result is the same. And that result obviates Irwin's asserted need to probe the reasonableness of the total broker compensation in any individual transaction. Moreover, the plaintiffs add, it would be absurd to judge the nature of the payment on the basis of the broker and borrower's intent in a particular transaction, and thus Irwin's fallback argument is meritless. The plaintiffs conclude that there is accordingly no need to look at any individual transaction to determine liability, and that class certification is therefore appropriate.

These arguments framing the debate, we turn to determining the rule of liability prescribed by the HUD Statement.

Discussion

We agree with the plaintiffs' view of the rule of liability. Reaching that conclusion requires us to answer two questions. The first is interpretation of the HUD Statement: What does "for compensation paid" mean when HUD asks us in the first step of its two-step test to determine "whether goods or facilities were actually furnished or services were actually performed for the compensation paid"? HUD Statement at 10084. On one hand, if "for compensation paid" means "in exchange for compensation paid," then the plaintiffs correctly assert that the inquiry in this step includes not only whether the broker performed services, but also whether the broker performed the services as part of a services-for-money exchange. On the other hand, if "for compensation paid" means nothing at all, or if the phrase means "in connection with the loan transaction," as one district court has read it,[13] then Irwin

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[13] *Schmitz v. Aegis Mortgage Corp.*, 48 F.Supp.2d 877, 882 (D.Minn. 1999).

is right that all we need to know for the first step is whether the broker did any work on a particular transaction. (They would also be right that *Culpepper I* is possibly no longer good law, and we would have to decide whether it would nonetheless be law of this case.)

The second question arises from Irwin's fallback argument: Does the borrower and broker's subjective intent determine whether Irwin's payment to the broker is part of a services-for-money exchange? This question turns more on interpretation of *Culpepper I* because the HUD Statement is silent.

What does "for compensation paid" mean?

Three reasons persuade us that the plaintiffs' construction of the HUD Statement, and their explanation of how it fits with *Culpepper I*, is superior to Irwin's.

First, Irwin's preferred construction of HUD's language simply does not fit the language, while the plaintiffs' proposed reading fits very well. To begin with, it would be anomalous to ignore "for compensation paid" as sloppy drafting on HUD's part. Rational agency regulations have the force of law, and it is a "cardinal principle of statutory construction that we must 'give effect, if possible, to every clause and word of a statute.'" *Williams v. Taylor*, 529 U.S. 362, 120 S.Ct. 1495, 1519, 146 L.Ed.2d 389 (2000) (quoting *United States v. Menasche*, 348 U.S. 528, 538-39, 75 S.Ct. 513, 520, 99 L.Ed. 615 (1953)) (internal quotation omitted). To give the phrase the meaning that Irwin would assign to it, moreover, ("in connection with the loan transaction") is impossible with our, and possibly any ordinary, use of the English language. On the other hand, the plaintiffs' suggestion that "for compensation paid" means "in exchange for compensation paid" is semantically very plausible. *See* Webster's Third International Dictionary 886 (unabridged ed. 1981) (defining "for" to mean "in exchange as the equivalent of" or "in requital of").

Second, Irwin's reading of the Statement is not only inconsistent with the Statement itself; it also would make the Statement clash with § 8(c)'s language. Section 8(c) authorizes "the payment of a fee ... by a lender ... for services actually performed." 12 U.S.C. § 2607(c)(1)(C). As we pointed out in discussing the HUD Statement's own language, the preposition "for" connotes an exchange. The word "fee," moreover, implies a planned money-services exchange even more strongly than "compensation." *Compare* Black's Law Dictionary 629 (7th ed. 1999) ("fee" means "a charge for labor or services") *with id.* 277 ("compensation" means both "damages" and "[r]emuneration ... in return for services rendered; esp., salary or wages"). The statute itself thus implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor, and we hesitate to read the HUD Statement to stray from the statute by imposing no such limit on legality.

Third, accepting Irwin's view would have the HUD Statement create an inconsistency between § 8(a)'s liability test and § 8(c)'s exclusion from liability. Everything about § 8(c) suggests that it is an interpretive gloss on § 8(a) rather than a list of exemptions bestowed upon otherwise illegal conduct. Section 8(c)'s language starts with "[n]othing in this section shall be construed as prohibiting," not with "notwithstanding § 8(a)" or any other plain exception language. 12 U.S.C. § 2607(c). The Senate report explains that § 8(c)'s purpose was to "set[] forth the types of legitimate payments that would not be proscribed" by § 8(a). S.Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6552. And HUD introduces its regulatory list of payments that are proper under § 8(c) with the phrase "Section 8 of RESPA permits," not some language of exception. 24 C.F.R. § 3500.14(g)(1). If § 8(c) is only a gloss on § 8(a), making clear what § 8(a) allows in certain contexts,

we should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws.

That is exactly what Irwin's reading of the HUD Statement would do. The crux of § 8(a)'s liability test, even when the suspected referral fee is dressed up as something else, is whether the payment is to compensate a referrer for referrals; the answer to that question lies in the terms of the agreement between the referrer and the recipient of the referral. *See, e.g.*, 24 C.F.R. pt. 3500 app. B exs. 1, 2, 6 (noting explicitly in the examples that the parties are swapping value for referrals); *Lawyers Title Ins. Corp. v. Dearborn Title Corp.*, 118 F.3d 1157, 1162 (7th Cir. 1997) (focusing on the reason for a rent payment—whether it was to secure referrals or for other reasons—in determining § 8(a) liability, without asking whether the total rent was reasonable); *Aiea Lani Corp. v. Haw. Escrow & Title, Inc.*, 64 Haw. 638, 647 P.2d 257, 262 (1982) (asking only if the reason for a reduced title insurance premium was in exchange for referrals, not whether the premium was otherwise reasonable). Under § 8(a), a payment whose reason is to compensate for referrals is illegal, period. If Irwin has read the HUD Statement correctly, however, HUD has now decided that § 8(c) deems *some* such referral fees legal—that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were. The plaintiffs' reading of the HUD Statement, by contrast, keeps § 8(c) as a gloss on § 8(a): Paying referral fees may be prohibited (as § 8(a) provides), but paying service fees is not (as § 8(c) provides), unless of course the lender pays so much that we can legitimately suspect a disguised referral fee. We prefer this reading of the HUD Statement, which preserves the harmony of § 8(a) and 8(c).

The structure and language of the HUD Statement and of RESPA § 8 thus support the plaintiffs' proposed rule of liability far better than Irwin's. Irwin maintains

nonetheless that accepting the plaintiffs' view runs afoul of HUD's remark that yield spread premiums are not "illegal *per se*." HUD Statement at 10084 (italics in original). We do not think so. Our speculation on the outcome of other cases is of course dicta, but there is no reason to think that under the HUD Statement and *Culpepper I* a yield spread premium could not pass muster if the agreement to pay it bore the hallmarks of a fee-for-service exchange—if, for instance, Irwin required brokers to present a bill showing the services rendered, and how much the broker had collected in fees from the borrower, or if Irwin followed the advice of the Senate report to "persons and companies that provide settlement services" that they "ensure that any payments they make ... are not out of line with the reasonable value of the services received." S.Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6551. So our holding is consistent not only with this remark by HUD, but also with *Culpepper II*'s similar observation about its holding. *See* 144 F.3d at 718.

We accordingly hold that the first step in the test for liability under § 8 is not only whether the broker performed some of the services described in the HUD Statement, but also whether the yield spread premium is payment for those services rather than for a referral. The core theory of the plaintiffs in this case is that Irwin's yield spread premiums are referral fees, and that we therefore need not reach the second step, which is whether the broker's total compensation was reasonable.[14] Because the plaintiffs could thus prevail solely by showing that Irwin's yield spread premiums are referral fees, and not service fees, class treatment under Fed.R.Civ.P. 23(b)(3) is appropriate

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[14] The plaintiffs do have a fallback position, which is reflected in the class definition and which we need not discuss here, that FHA regulations applicable to FHA loans make any compensation to the broker over 1% of the loan value per se unreasonable.

unless that threshold question itself demands loan-by-loan evidence. Which brings us to the defendants' fallback argument.

How do we tell whether there is a services-for-money exchange?

That argument, as we explained above, is that the nature of the yield spread premium is a product of the subjective intent of the broker and borrower. That intent, Irwin continues, must be ascertained loan-by-loan because each loan of course has a different borrower. The plaintiffs counter that *Culpepper I*'s analysis suggests that the standardized terms under which Irwin pays yield spread premiums can by themselves prove that yield spread premiums are fees for referrals.

We agree with the plaintiffs that *Culpepper I* does not imply Irwin's proposed rule, which (because of the element of a third party's subjective intent) would put Irwin in the bizarre position of not knowing whether its conduct was illegal when it committed it. Irwin's best source for the rule in *Culpepper I* is a single remark: "No evidence suggests that [the fee paid by the Culpeppers to their broker, Premiere] was not intended by both Premiere and the Culpeppers to compensate Premiere fully for the work it did for the Culpeppers." 132 F.3d at 696. This sentence does not, read in context, necessarily imply that broker and borrower intent ultimately determines whether Irwin's payment of a yield spread premium is for services or referrals. *Culpepper I*'s holding is that the terms of the implicit yield-spread-premium deal between Irwin and its brokers permit a jury to find that the premiums are referral fees. The panel reviews those terms and concludes in effect that a jury could reasonably infer that Irwin is really buying referrals. After all, Irwin may not know what services it has received when it pays the premium, but it does know that it has gotten a referral. The remark on which Irwin

relies is best read in this context as a record observation. The court is merely implying that on the present record, Irwin looks to be wrong that, because brokers rely on the premiums for compensation, Irwin is buying services. We prefer not to take this remark out of context and promote it into an element of liability.

We therefore adopt the sounder rule, the one that *Culpepper I*'s reasons for denying summary judgment plainly imply, that the terms and conditions under which a lender pays the broker a yield spread premium can determine whether the yield spread premium is compensation for referring loans rather than a bona fide fee for services. There is no suggestion from the evidence or the argument here that Irwin negotiates yield spread premiums loan-by-loan, rather than paying them according to terms and conditions common to all the loans. Nor does Irwin contend that it intends some yield spread premiums to pay for services and others to pay for referrals. Given the test for liability that we interpret the HUD Statement and *Culpepper I* to impose, in these circumstances the district court acted within its discretion in determining that common questions of law and fact predominate and that class certification is thus appropriate under Fed.R.Civ.P. 23(b)(3).[15]

Conclusion

For the foregoing reasons, the district court's certification of the described class is affirmed.

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[15] Irwin argues briefly that the plaintiff Beatrice Hiers is not an adequate class representative because, having paid less than 1% of her loan value as a broker fee, she is not a member of the presently defined class. The Culpeppers' adequacy is unchallenged, and this issue about Hiers does not therefore affect the outcome of the appeal. Because the district court's certification order does not address the question of Hiers's adequacy, we leave the question open for the district court to consider in the first instance.

AFFIRMED.

EDMONDSON, Circuit Judge, concurs in the judgment.

APPENDIX B

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DISTRICT

Nos. CV 96-BU-0917-S, CV 98-BU-2187-S.

John Robert Culpepper & Patricia Starnes Culpepper, et al.,
Plaintiffs,

v.

Inland Mortgage Corporation, Defendant.

Beatrice N. Hiers, individually and as a
representative of a class of similarly situated persons,
Plaintiff,

v.

Irwin Mortgage Corporation d/b/a Inland
Mortgage Corporation, Defendant.

March 1, 1999.

ORDER

BUTTRAM, District Judge.

This cause comes on to be heard on a motion for class certification filed by the plaintiffs in CV 96-BU-0917-S, John Robert Culpepper and Patricia Starnes Culpepper, and the plaintiff in CV 98-BU-2187-S, Beatrice N. Hiers, on

February 25, 1999. In their motion, the plaintiffs request certification under Federal Rule of Civil Procedure 23(b)(3) of a class defined as follows:

> All persons who, from April 11, 1995, until this class is certified, inclusive, obtained an FHA mortgage loan that was funded by Irwin Mortgage Corporation wherein the broker was paid a loan origination fee of 1% or more and wherein Irwin paid a "yield spread premium" to a mortgage broker.

The defendant, Irwin Mortgage Company, opposes the certification of the above-defined class, stating that such class would satisfy neither the typicality and adequacy requirements of Federal Rule of Civil Procedure 23(a) nor the predominance and superiority requirements of Federal Rule of Civil Procedure 23(b)(3). The plaintiff disputes this.

> The class-action device was designed as "an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only." *Califano v. Yamasaki*, 442 U.S. 682, 700-701, 99 S.Ct. 2545, 61 L.Ed.2d 176[ ]. Class relief is "peculiarly appropriate" when the "issues involved are common to the class as a whole" and when they "turn on questions of law applicable in the same manner to each member of the class." *Id.*, at 701, 99 S.Ct. 2545[ ]. For in such cases, "the class-action device saves the resources of both the courts and the parties by permitting an issue potentially affecting every [class member] to be litigated in an economical fashion under Rule 23." *Ibid.*

General Telephone Company of the Southwest v. Falcon, 457 U.S. 147, 155, 102 S.Ct. 2364, 72 L.Ed.2d 740 (1982). A district court is to make the determination of whether an action should proceed as a class action "[a]s soon as practicable after the commencement of an action brought as a class action...." Fed.R.Civ.P. 23(c)(1). *See American Pipe*

& Const. Co. v. Utah, 414 U.S. 538, 547, 94 S. Ct. 756, 38 L.Ed.2d 713 (1974), *reh'g denied*, 415 U.S. 952, 94 S. Ct. 1477, 39 L.Ed.2d 568. "The decision to certify is within the broad discretion of the court, but that discretion must be exercised within the framework of rule 23." *Castano v. American Tobacco Co.*, 84 F.3d 734, 740 (5th Cir. 1996).

The party desirous of certification of a class bears the burden of demonstrating the existence of the prerequisite for certification set forth in Federal Rule of Civil Procedure 23(b). That the named plaintiffs must demonstrate the basis for class certification does not entail that the named plaintiffs must prove the merits of the substantive claims of the proposed class. *See Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 178, 94 S.Ct. 2140, 40 L.Ed.2d 732 (1974) ("In determining the propriety of a class action, the question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met."). Nonetheless, the court must sometimes inspect certain core facts not presented in the pleading when the court must "understand the claims, defenses, relevant facts, and applicable substantive law in order to make a meaningful determination of certification issues." *Castano v. American Tobacco Co.*, 84 F.3d at 744.

Background

On April 11, 1996, plaintiffs John Robert Culpepper and Patricia Starnes Culpepper filed their complaint in the instant action, claiming that the defendant, Irwin, paid the broker who originated their mortgage a kickback of $1,263.21 in violation of § 8 of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. § 2607. Plaintiff Beatrice N. Hiers filed an action on August 28, 1998, also alleging that the defendant paid a kickback to her mortgage originator (broker) in violation of § 8 of RESPA, in the amount of $4,538.37. Many of the facts regarding the Culpeppers and Irwin that are relevant to the instant

motion were recounted in the Eleventh Circuit Court of Appeals' opinion in *Culpepper v. Inland*, 132 F.3d 692, 694-95 (11th Cir. 1998):

A. The Yield Spread Premium

The pertinent facts are undisputed. John and Patricia Culpepper ("the Culpeppers") obtained a federally insured home mortgage loan from Inland Mortgage Corp. ("Inland"). The Culpeppers did not deal directly with Inland, but dealt with Premiere Mortgage Company ("Premiere"), a mortgage broker.

Inland, like other lenders, sends Premiere daily rate sheets that show the types of loans Inland will make to qualified borrowers. Each type of loan has a benchmark interest rate called the "par rate." This is the lowest interest rate at which Inland will make loans without charging the borrower "discount points." If Premiere as the mortgage broker brings Inland a loan at a "below par rate," then Inland requires Premiere, who then requires the borrower, to pay discount points for the loan. However, if Premiere brings Inland a loan with interest at an "above par rate," then Inland pays a "yield spread premium" to Premiere.

On December 7, 1995, Premiere received a rate sheet from Inland and informed the Culpeppers that a 30-year loan was available at a 7.5% interest rate. The Culpeppers accepted the rate, and Premiere registered the loan with Inland. Unbeknownst to the Culpeppers, the rate sheet showed that 7.5% was higher than Inland's par rate on 30-year loans and carried a yield spread premium of 1.675% of the loan amount, or $1,263.61. Premiere quoted the 7.5% rate notwithstanding the fact that Inland would make the same loan at 7.25%. At that lower interest rate, the

yield spread premium paid to Premiere would be only 0.125% of the loan amount, or $97.20.

When the transaction closed on December 15, 1995, the Culpeppers paid Premiere an origination fee of $760.50 for Premiere's assistance in obtaining and closing their loan. Then, Inland paid Premiere the yield spread premium of $1263.21. The Culpeppers do not challenge the origination fee they paid to Premiere. Rather, their claim focuses solely on the legitimacy of Inland's yield spread premium payment under RESPA.

B. Calculating The Yield Spread Premium

Inland's formula for determining the size of the yield spread premium was not tied to services, but to the size and interest rate of the Culpeppers' loan. Inland's rate sheet shows that the amount of the yield spread premium was solely a function of the extent to which the interest rate on the loan exceeded Inland's par rate. Indeed, the services provided by Premiere were the same irrespective of the interest rate.

C. Table Funded Transactions

One final facet of this loan is important to the court's decision in this case. Although Premiere was the nominal creditor on the loan documents, Premiere did not fund the Culpeppers' loan. Instead, Inland advanced the funds and Premiere contemporaneously assigned the loan to Inland. This type of brokerage arrangement is known as "table funding;" thus, Inland, not Premiere, owned the Culpeppers' mortgage from the outset.

Hiers obtained her $159,750.00 FHA mortgage on August 29, 1997, after shopping around for a preferable interest rate. The first loan for which she became qualified

was a 7.5% fixed-rate mortgage to be provided through Countrywide Mortgage. Believing that she could obtain a better interest rate, the plaintiff contacted Home Buyer's Mortgage, Inc., ("Home Buyer's") and obtained what she believed at the time the mortgage was offered to be a 7% fixed-rate mortgage. At the time of closing, however, it was revealed to her that the mortgage was in fact an adjustable rate mortgage.

At closing, Home Buyer's received $10,004.45, consisting of $744.00 paid directly from Hiers, an $800.00 lender credit belonging to Hiers, $4,721,58, paid as a 3% discount fee from the sellers, and a $4,538.87 yield spread premium paid directly from Irwin. Like the Culpeppers, Hiers's claims do not involve the payment of the origination fee to Home Buyer's, but focuses on the yield spread premium paid to Home Buyer's by the defendant.

Contentions & Analysis

The plaintiff seeks certification of a class pursuant to Federal Rule of Civil Procedure 23(b)(3), which states, in relevant part:

> (a) **Prerequisites to a Class Action.** One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.
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> (b) **Class Actions Maintainable.** An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
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> * * * * * *

> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of the members of the class in individually controlling the prosecution and defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

Fed.R.Civ.P. 23(a) & (b)(3). "In the 1966 class-action amendments, Rule 23(b)(3) ... was 'the most adventuresome' innovation[,] ... add[ing] to the complex-litigation arsenal class actions for damages designed to secure judgments binding all class members save those who affirmatively elected to be excluded." *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 614, 117 S.Ct. 2231, 2245, 138 L.Ed.2d 689 (1997).[1] Thus, "the federal class action is no

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[1] To some degree, the Rule 23(b)(3) class is to be compared to the class it replaced in the 1966 class-action amendments, the so-called "spurious class." In *Snyder v. Harris*, 394 U.S. 332, 335, 89 S.Ct. 1053, 22 L.Ed.2d 319 (1969), a case essentially about aggregation of claims, the Supreme Court briefly spelled out the differences between the types of class actions maintainable prior to 1966 and the basis for categorization of class actions after the 1966 rule:

> Under old Rule 23, class actions were divided into three categories which came to be known as 'true,' 'hybrid,' and 'suprious.' True class actions were those in which the rights of the different class members were common and undivided; in such cases aggregation was permitted. Spurious class actions, on the other hand, were in essence merely a form of permissive joinder in which parties with separate and distinct claims

longer 'an invitation to joinder' but a truly representative suit designed to avoid, rather than encourage, unnecessary filing of repetitious papers and motions." *American Pipe & Const. Co. v. Utah*, 414 U.S. at 550, 94 S.Ct. 756. *See Matter of American Reserve Corp.*, 840 F.2d 487, 489 (7th Cir. 1988) ("Class actions have procedural and substantive advantages. Procedurally, the class action concentrates litigation in a single forum, where it may be resolved more readily than a series of suits could be.").

The central contention of the defendant is that because of the fact intensive nature of the analysis into the reasonableness of the "total compensation" to the broker, typicality under Rule 23(a)(3) does not exist [2] and that the

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were allowed to litigate those claims in a single suit simply because the different claims involved common questions of law or fact. In such cases aggregation was not permitted: each plaintiff had to show that his individual claim exceeded the jurisdictional amount. The 1966 amendment to Rule 23 replaced the old categories with a functional approach to class actions. The new Rule establishes guidelines for the appropriateness of class actions, makes provision for giving notice to absent members, allows members of the class to remove themselves from the litigation and provides that the judgment will include all members of the class who have not requested exclusion.

One of the changes consequent to replacing 'spurious' class actions with Rule 23(b)(3) class actions was that rather than treating the class vehicle as a form of grand joinder—an opt-in vehicle, the class vehicle was treated as a representative suit for all members of the defined class except those who did not wish to partake in the class. This focus upon representation necessitated a *functional* similarity amongst the class members, that is, while each individual class member may have some different particulars to his or her claim, for purposes of resolving the core matters of the suit, any class member was functionally as good as another.

[2] In *Kornberg v. Carnival Cruise Lines, Inc.*, 741 F.2d 1332, 1337 (11th Cir. 1984), the Eleventh Circuit Court of Appeals explained, in general, what factors bear on the determination of whether the claims or defenses of the class representative are typical of those belonging to the class.

A class representative's claims or defenses must be typical of the claims or defenses of the class. Fed.R.Civ.P. 23(a)(3). In other words, there must be a nexus between the class representative's claims or defenses and the common questions of fact or law which unite the class. A

facts as to each individual purchase will predominate over the common issues in violation of Rule 23(b)(3).[3] The court finds this to be incorrect. The Eleventh Circuit Court of Appeals, in the original *Culpepper* opinion, stated that it was not required to investigate the reasonableness of the compensation provided to the broker because the yield spread premium paid was neither a payment for goods or

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sufficient nexus is established if the claims or defenses of the class and the class representative arise from the same event or pattern or practice and are based on the same legal theory. Typicality, however, does not require identical claims or defenses. A factual variation will not render a class representative's claim atypical unless the factual position of the representative markedly differs from that of other members of the class. *Edmondson v. Simon*, 86 F.R.D. 375, 380-81 (N.D. Ill. 1980); *Senter v. General Motors Corp.*, 532 F.2d 511, 525 n. 31 (6th Cir. 1976), *cert. denied*, 429 U.S. 870, 97 S. Ct. 182, 50 L.Ed.2d 150[ ] (1976); 3B J. Moore & J. KENNEDY, MOORE'S FEDERAL PRACTICE ¶ 23.06-2 at 191-92 (2d ed. 1982); 7 C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1764 (1972).

See also Washington v. Brown & Williamson Tobacco Corp., 959 F.2d 1566, 1569 n. 8 (11th Cir. 1992) (stating that the commonality, typicality and fair representation requirements of class certification tend to merge and that "[c]ommonality and typicality represent the 'nexus' necessary between class representatives and class members"), and *Taylor v. Flagstar Bank, FSB*, 181 F.R.D. 509, 516 (N.D.Ala. 1998) (noting that the typicality requirement presents "somewhat of a low hurdle" to the purported class representative seeking certification).

[3] "The Rule 23(b)(3) predominance inquiry tests whether proposed classes are sufficiently cohesive to warrant adjudication by representation." *Amchem Products, Inc. v. Windsor*, 521 U.S. at 594, 117 S. Ct. at 2249. Therefore, the examination of predominance "focuses on 'the legal or factual questions that qualify each class member's case as a genuine controversy,' and is 'far more demanding' than Rule 23(a)'s commonality requirement." *Jackson v. Motel 6 Multipurpose, Inc.*, 130 F.3d 999 (11th Cir. 1997) (citing *Amchem Products, Inc. v. Windsor*, 521 U.S. at 594, 117 S.Ct. at 2249-50). The locus of the predominance inquiry is whether those common issues of law and fact presented by the case are overwhelmed by the particular factual and legal inquires that the case might present. *See Andrews v. American Telephone & Telegraph Company*, 95 F.3d 1014 (11th Cir. 1996). If resolution of the central inquiry of the class claim "breaks down into an unmanageable variety of individual legal and factual issues," class certification is inappropriate. *Id.*

services. *Culpepper v. Inland Mortgage Corporation*, 132 F.3d at 697. The facts on which the Court of Appeals reached its decision is built into the class definition provided by the plaintiffs. For example, the Court of Appeals determined that the yield spread premium paid to Premiere could not be a payment for goods if the loan to the Culpeppers was table-funded—that is, Irwin provided the funds for the mortgage and was therefore not paying Premiere for the loan. The Culpeppers and Heirs thus limit the relevant class to those persons whose loans were table-funded. Further, the Court held that the yield spread premium could not be a payment for services, either to the Culpeppers or Irwin because (1) the defendant had no evidence that the 1% origination fee charged by Premiere was not meant to compensate it completely and (2) because the amount of the yield spread premium was not tied in any fashion to the amount of services paid either to the Culpeppers or Premiere. The definition of the class again attempts to draw these distinctions into the definition of the class. The plaintiffs limit the class to those individuals who acquired FHA loans and who paid a 1% loan origination fee for the services provided to them by the broker. Because the broker could charge no more under applicable FHA regulations, the plaintiffs contend, the 1% origination fee fully compensates the broker for its services. This may often be the case, but, the defendant might be able to demonstrate that in some instances the yield spread premium was tied to the services provided by brokers to either it or to putative class members. However, such proof will, of necessity, be of a general nature, such as memoranda dictating that the amount of yield spread premiums paid is to be increased or decreased based upon the services provided and will not be fact specific. The class meets both the typicality and predominance requirements of Rule 23.

The defendant insists, however, that this Court will be required to analyze the reasonableness of each loan

transaction. Given the definition of the class, this issue is likely never to arise. Indeed, it will only arise if the defendant is somehow capable of demonstrating, contrary to proof otherwise by the plaintiffs, that the yield spread premium is tied in some fashion to the services provided it by the broker. This, the defendant has been at this point unable to do. In so stating, the Court is not indicating that the defendant carries the burden of proof; rather, it is noting that, at this stage, the plaintiff has presented evidence that the yield spread premium is unconnected to anything but the difference between the par rate and the interest rate at which the mortgage was made. The claims of the plaintiffs and any putative class hang largely, almost exclusively, on this issue. *See Dujanovic v. MortgageAmerica*, 185 F.R.D. 660, 672-73 (N.D.Ala. 1999). Therefore, there are insufficient factual particulars to overwhelm this issue.[4]

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[4] The defendant raises the argument that plaintiff Hiers is an inadequate class representative because a portion of her loan origination fee was paid for with a lender credit. This does not detract from the fact that Hiers paid a 1% loan origination fee. Therefore, adequate representation exists between Hiers and the class.

The class also meets the superiority requirement. As Magistrate Judge Putnam stated in *Dujanovic v. MortgageAmerica*, 185 F.R.D. 660, 672-73 (N.D.Ala. 1999):

> While the court is always mindful of any litigant's interest in controlling his own action, that interest is not unusually compelling in this case, which is similar to other class actions that have challenged the propriety of a financial institution's charges or practices. Class actions have been found to be particularly appropriate where a large number of borrowers seek relief from a course of conduct that violates laws aimed at preventing misconduct by lenders, but where the amount of each borrower's damages may be too small to warrant individual lawsuits. *Cohen v. District of Columbia Nat'l Bank*, 59 F.R.D. 84 (D.D.C. 1972). As is common in these types of lawsuits, the amount of damages for each individual class member often would be too small to justify a separate action.

There has been no indication that any other litigation on this issue against this defendant has been commenced, although there have been

Conclusion

For the forgoing reasons, the plaintiffs' motion for class certification is GRANTED.

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numerous lawsuits challenging the same practice. Consequently, treatment of this action as a class action could determine whether [defendant's] practice is violative of RESPA without subjecting the defendant to duplicative lawsuits.

APPENDIX C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DISTRICT

Nos. CV 96-BU-0917-S, CV 98-BU-2187-S.

John Robert Culpepper & Patricia Starnes Culpepper, et al., Plaintiffs,

v.

Inland Mortgage Corporation, Defendant.

Beatrice N. Hiers, individually and as a a representative of a class of similarly situated persons, Plaintiff,

v.

Irwin Mortgage Corporation d/b/a Inland Mortgage Corporation, Defendant.

July 20, 1999.

ORDER

BUTTRAM, J.

This cause comes on to be heard on a motion to stay filed by Defendant Irwin Mortgage Corporation on July 13, 1999 (Document 70). For reasons substantively identical to those set forth by Magistrate Judge Putnam in *Dujanovic v. MortgageAmerica, Inc.*, CV 98-TMP-0235-S, Order Granting Stay Pending Appeal (N.D. Ala. April 21, 1999), the motion is GRANTED. All proceedings in the instant action are hereby STAYED pending resolution of Defendant's discretionary appeal and/or a ruling of the Eleventh Circuit Court of Appeals in *Hirsch v. BankAmerica Corporation*, No. 99-90010-D, and in *McBride v. Reliastar Mortgage Company*, 99-90011-A.

In granting the Plaintiff's motion for class certification, this court relied heavily on the specific tailoring of the class in the instant action and its fit to the relevant determinative facts in the Eleventh Circuit Court of Appeals's opinions in *Culpepper v. Inland Mortgage Company*, 132 F.3d 692 (11th Cir. 1998), and *Culpepper v. Inland Mortgage Company*, 144 F.3d 717 (11th Cir. 1998). It has been argued, however, that the *Culpepper* cases no longer provide the authoritative analysis of whether a yield spread premium constitutes a kickback proscribed by section 8 of the Real Estate Settlement Procedures Act ("RESPA"). Rather, the governing analysis is that set forth in a recent statement of policy issued by the Department of Housing and Urban Development ("HUD").[1] While this Court maintains that the *Culpepper* decisions by the Court of Appeals of this Circuit still control the analysis of when or whether a yield spread premium paid by a lender will constitute a RESPA violative kickback, *see* RESPA Statement of Policy 1999-1 Regarding Payments to Mortgage Brokers, 64 Fed. Reg. 10080, 10084 (1999) ("RESPA Policy Statement"), it will,

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[1] HUD has the authority to develop rules and regulations interpreting and applying RESPA.

nonetheless, provide an explanation why, under the HUD's policy statement, class certification is still appropriate.

The RESPA Policy Statement provides a discerning portrait of recent interpretations of the anti-kickback provisions of RESPA by the various courts:

> During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers' fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.
>
> Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread

premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

64 Fed. Reg. at 10083-84. Responding to this, HUD attempted to provide some consistent guidance on the issue of when and whether a yield spread premium would violate section 8 of RESPA.

Eschewing a nominalist approach to the legality of yield spread premiums, HUD observed, echoing the Eleventh Circuit Court of Appeals, that a yield spread premium is not "illegal per se." *Id.* at 10084. *See Culpepper v. Inland Mortgage Company,* 144 F.3d at 718 ("The central issue presented by this litigation is not whether yield spread premium payments by a mortgage lender can ever be lawful; they can in certain circumstances."). However, HUD recognized that while there exists no *per se* bar on yield spread premiums, in certain "individual cases or *classes of transactions*" a yield spread premium will be a kickback in violation of section 8 of RESPA. 64 Fed. Reg. at 10084 (emphasis added).

The RESPA Policy Statement then sets forth its test for determining when a payment from a lender to a mortgage broker constitutes an illegal kickback.

> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Id. at 10084. The test set forth by HUD as to whether a payment from a lender to a mortgage broker is an illegal kickback under the Policy Statement has two prongs. First,

is whether goods were provided (other than the subject loan or rights, the value of which are inherently tied to the value of the interest rate of the subject loan, such as excess servicing fees) or services were performed on behalf of the lender or the borrower for the compensation paid. This prong actually has two subprongs that the lender (after the borrower has set forth its *prima facie* case) must prove: (1) that goods or services were provided by the mortgage broker to the lender or the borrower and (2) that the lender paid compensation for the goods and services. The second prong is whether the payments made are reasonably related to the goods or services actually furnished.

While the RESPA Policy Statement goes into detail in describing the first subprong, *see id.* at 10085, it fails to elucidate in similar detail the second subprong. It is HUD's failure to provide a clear explanation of this second subprong that has engendered some confusion in the district courts evaluating the class certification issue and the substantive matter of when a RESPA violation occurs. For example, in *Levine v. North American Mortgage*, CV 98-556, Memorandum Opinion and Order Denying Plaintiff's Motions for Class Certification and Summary Judgment at 14-15 (D.Minn. 1999), the district court stated that to prove a violation of the anti-kickback provision of RESPA, the first question to be resolved was simply whether the broker actually provided goods or services. If that question was answered in the affirmative, the fact-finder was then to determine whether the payment provided by the lender was "reasonably related to the goods or services furnished or performed." *Id.* In coming to this conclusion, the district court attended to the following language in the RESPA Policy Statement:

> The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as

> described in the IBAA letter, does not by itself make a payment by a lender to a mortgage broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Id. at 14 (citing 64 Fed. Reg. 10085-86) (emphasis as added by district court). The quoted language is ostensibly confusing in light of earlier statements that compensation by the lender must be for the goods or services. On its surface, the quoted language would indicate that once the lender shows that goods have been provided or services performed, the fact-finder is then left with the issue of whether there exists a reasonable relation between the goods provided or services performed and the payment. However, under this reading of the RESPA Policy Statement, as adopted by some district courts, it is unnecessary for there to be any inherent relation at the time of the transaction between the goods or services provided and the amount paid, thereby permitting a post hoc rationalization to stand in for a reasonable relationship of the lender's payment to the goods and services provided. That is, it permits a lender who, at the time of procuring a loan, pays a yield spread premium for that value, to skirt the anti-kickback provisions of RESPA by manufacturing, after the fact, a reasonable relationship between the value of the services or goods provided and the yield spread premium paid. More simply, it permits the lender who says "sure, it was a referral fee at the time, but it could reasonably have served as payment for goods or services" to duck liability.

Therefore, this Court reads HUD's RESPA Policy Statement to include, in the first prong of the analysis, the requirement faithfully reproduced, with the noted exception, throughout HUD's explication of the test for determining when a payment is a prohibited referral -, i.e.,

the requirement that the payment actually be compensation for the goods or services provided. In the instant case, there has been virtually no demonstration by the Defendant, whatever the goods or services provided in the individual cases, that its payment of the yield spread premium was intended to be anything more or less than a payment in exchange for the value of the mortgages provided it and the right to service the loan (an amount tied to the loan's value). *See Culpepper v. Inland Mortgage Company*, 132 F.3d at 696. Thus, even if HUD's RESPA Policy Statement does govern the instant action, the predominant matter remains the same as if this Court proceeded under the *Culpepper* decisions—that is, the Plaintiffs' claims will rise or fall on whether the yield spread premiums in question were meant to compensate the mortgage brokers for goods or services provided or were meant to pay for the increased value of a loan.

The argument has been advanced that, even on this issue, class certification is inappropriate, as various individual mortgage brokers might apply the yield spread premium to their own compensation from the borrower for goods or services provided and an individualized investigation into the conduct of each mortgage broker with respect to each loan made would predominate over the common issues. This argument, however, blurs the distinction between a payment made by the lender to the mortgage broker as compensation for goods or services and a payment made by the lender to the mortgage borrower that the borrower applies to its own compensation for goods or services. It is the purpose of the payment, not the subsequent use of that payment, that is the object of the anti-kickback provision of RESPA. It is irrelevant to RESPA's purposes whether the mortgage broker uses the payment to compensate itself for providing goods or services, to compensate itself for negotiating a high-interest loan, or to advertise its business in order to lure further

individuals into its office. Thus, the requirement that the payment actually be for the goods or services provided cannot be satisfied by a mere demonstration that the mortgage broker applied the yield spread premium to the amount of its own compensation for goods or services. The key to the RESPA violation is the purpose of the payment, the determination of which can be made on a general, class-wide basis by focusing on the Defendant's stated goals or objectives in paying a yield spread premium.

Also pending before the Court is a motion by the Plaintiffs, John Robert Culpepper, Patricia Starnes Culpepper, Beatrice N. Hiers, filed on May 5, 1999 (Document 56). The Court finds this motion to be premature and therefore DENIES said motion. The Plaintiffs (as well as Defendant) are encouraged to renew their motions for summary judgment after the Court lifts its stay in this action.

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 97-6109

John Robert Culpepper, Patricia Starnes Culpepper, in behalf of themselves and, all others similarly situated, Plaintiffs-Appellants

v.

Inland Mortgage Corporation, Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Alabama

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January 9, 1998

Before EDMONDSON and HULL, Circuit Judges, and CLARK, Senior Circuit Judge.

OPINION

HULL, Circuit Judge:

This appeal concerns whether a mortgage lender's payment of a "yield spread premium" to a mortgage broker violates the anti-kickback provision of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2601, *et seq.* ("RESPA"). The district court granted summary judgment to defendant Inland Mortgage Corp. and held that the

payment it made was not prohibited by RESPA. After review, we disagree and reverse.[1]

I. FACTS

A. The Yield Spread Premium

The pertinent facts are undisputed. John and Patricia Culpepper ("the Culpeppers") obtained a federally insured home mortgage loan from Inland Mortgage Corp. ("Inland"). The Culpeppers did not deal directly with Inland, but dealt with Premiere Mortgage Company ("Premiere"), a mortgage broker.

Inland, like other lenders, sends Premiere daily rate sheets that show the types of loans Inland will make to qualified borrowers. Each type of loan has a benchmark interest rate called the "par rate." This is the lowest interest rate at which Inland will make loans without charging the borrower "discount points." If Premiere as the mortgage broker brings Inland a loan at a "below par rate," then Inland requires Premiere, who then requires the borrower, to pay discount points for the loan. However, if Premiere brings Inland a loan with interest at an "above par rate," then Inland pays a "yield spread premium" to Premiere.

On December 7, 1995, Premiere received a rate sheet from Inland and informed the Culpeppers that a 30-year loan was available at a 7.5% interest rate. The Culpeppers accepted the rate, and Premiere registered the loan with Inland. Unbeknownst to the Culpeppers, the rate sheet showed that 7.5% was higher than Inland's par rate on 30-year loans and carried a yield spread premium of 1.675% of the loan amount, or $1,263.61. Premiere quoted the 7.5% rate notwithstanding the fact that Inland would make the same loan at 7.25%. At that lower interest rate, the yield

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[1] We review the district court's grant of summary judgment for Inland *de novo*. *Fitzpatrick v. City of Atlanta*, 2 F.3d 1112, 1117 (11th Cir. 1993).

spread premium paid to Premiere would be only 0.125% of the loan amount, or $97.20.

When the transaction closed on December 15, 1995, the Culpeppers paid Premiere an origination fee of $760.50 for Premiere's assistance in obtaining and closing their loan. Then, Inland paid Premiere the yield spread premium of $1263.21. The Culpeppers do not challenge the origination fee they paid to Premiere. Rather, their claim focuses solely on the legitimacy of Inland's yield spread premium payment under RESPA.

B. Calculating The Yield Spread Premium

Inland's formula for determining the size of the yield spread premium was not tied to services, but to the size and interest rate of the Culpeppers' loan. Inland's rate sheet shows that the amount of the yield spread premium was solely a function of the extent to which the interest rate on the loan exceeded Inland's par rate. Indeed, the services provided by Premiere were the same irrespective of the interest rate.

C. Table Funded Transactions

One final facet of this loan is important to the court's decision in this case. Although Premiere was the nominal creditor on the loan documents, Premiere did not fund the Culpeppers' loan. Instead, Inland advanced the funds and Premier contemporaneously assigned the loan to Inland. This type of brokerage arrangement is known as "table funding;" thus, Inland, not Premiere, owned the Culpeppers' mortgage from the outset.

II. DISCUSSION

The narrow issue is whether Inland's payment of a yield spread premium to Premiere for the referral of an above par loan is an illegal fee under RESPA or a valid payment for goods or services.

A. RESPA's Statutory Framework

In 1974, Congress enacted RESPA to protect home buyers "from unnecessarily high settlement charges caused by certain abusive practices."[2] 12 U.S.C. § 2601(a). Specifically, Congress intended to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services." *Id.* § 2601(b)(2). Toward that end, RESPA prohibits providers of settlement services from paying referral fees and kickbacks, as follows:

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

Id. § 2607(a). The funding and origination of mortgage loans were not originally settlement services under RESPA, but a 1992 amendment clarified that such activities were settlement services covered by the statute. *Id.* § 2602(3).

Although § 2607(a) prohibits referral fees, § 2607(c) exempts payments for goods or services from that prohibition, as follows:

> Nothing in this section shall be construed as prohibiting ... the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed ....

Id. § 2607(c).

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[2] A "settlement" in this context is simply the process of closing a federally related mortgage loan. 24 C.F.R. § 3500.2(b). A "settlement service" is "any service provided in connection with a prospective or actual settlement." *Id.*

B. Interpretation Of RESPA By Courts And Commentators

No circuit court has addressed whether a yield spread premium violates RESPA. Several district courts construed RESPA in similar cases and reached conflicting results. For example, in *DuBose v. First Security Savings Bank*, 974 F.Supp. 1426 (N.D.Ala. 1997), and *Martinez v. Weyerhaeuser Mort. Co.*, 959 F.Supp. 1511 (S.D.Fla. 1996), the courts denied the lenders' motions for summary judgment and found that a yield spread premium payment could constitute a prohibited referral fee. Likewise, in *Mentecki v. Saxon Mort., Inc.*, No.96-1629-A, slip op. (E.D.Va. Jan. 10, 1997), the court denied the lender's motion to dismiss and held that the borrowers stated a claim under RESPA by alleging that the payment of a yield spread premium was an unlawful kickback. On the other hand, in *Barbosa v. Target Mortgage Corp.*, 968 F.Supp. 1548 (S.D.Fla. 1997), the district court held that a yield spread premium was a lawful payment for services.

In addition, some legal commentators within the lending industry have cautioned that the practice of paying yield spread premiums may be illegal. *See, e.g., Robert M. Jaworski, Overages: To Pay or Not To Pay, That is the Question*, 113 Banking L.J. 909 (1996) (discussing uncertainty of the propriety of yield spread premium payments under RESPA); Leonard A. Bernstein, *RESPA Invades Home Equity, Home Improvement and Mobile Home Financing*, 48 Consumer Fin. L.Q. Rep. 194, 197 (1994) (questioning whether "overages" or yield spread premiums can be characterized as permissible payments for services under RESPA).

C. The Yield Spread Premium Was A Referral Fee Under § 2607(a)

Against this background, our first step is to determine whether the yield spread premium here was a referral fee.

Tracking § 2607(a), RESPA is violated if (1) a payment of a thing of value is (2) made pursuant to an agreement to refer settlement business and (3) a referral actually occurs.

Inland gave value to Premiere in the form of the yield spread premium, and that payment was made pursuant to their ongoing contractual relationship, whereby Premiere "registered" loans with Inland and Inland funded those loans. A referral actually occurred when Premiere chose to register the Culpeppers' loan with Inland and not with the other lenders with whom Premiere did business. These undisputed facts compel the conclusion that Inland's payment of the yield spread premium to Premiere was a referral fee, and thus a violation of RESPA, unless the payment falls within one of the exceptions listed in § 2607(c).

D. The Yield Spread Premium Was Not A Payment For Goods

As outlined above, § 2607(c) exempts fees for goods or services. The district court deduced that the yield spread premium was payment for a good—*i.e.*, the Culpeppers' loan—that Premiere sold to Inland. However, this deduction ignores the fact that in table-funded transactions the lender, not the broker, owns the loan from the outset. Premiere could not sell the Culpeppers' loan to Inland because Inland already owned it.

RESPA does not prohibit the sale of a mortgage loan in the secondary market. 24 C.F.R. § 3500.5(b)(7). Therefore, if Premiere funds a loan and then sells the loan to Inland for a profit, no RESPA violation occurs. To determine whether an exempt "bona fide transfer of a loan obligation" occurs:

> HUD will consider the *real* source of funding and the *real* interest of the funding lender. Mortgage broker transactions that are table-funded are not secondary market transactions.

Id. (emphasis added). Even though the loan documents referred to Premiere as the lender, the parties agree that

Inland was the source of the loan funds and was the true funding lender. Consequently, there was no legitimate transfer of ownership of the loan to Inland from Premiere, and the yield spread premium cannot be characterized as a payment for the sale of the loan under RESPA.

Inland concedes that the Culpeppers' loan was table-funded and did not constitute a secondary market transaction. Inland asserts, however, that this fact does not undermine its contention that Premiere owned a valuable asset that it sold to Inland. According to Inland, "Premiere's right to direct the disposition of the mortgage loan [to one of a number of wholesale lenders] is the attribute of 'ownership' that is meaningful in this context." (Appellee's Brief, at 22.) It is true that Premiere, by virtue of its contract with the Culpeppers, had the right to "direct the disposition" of the loan business to a lender of Premiere's choice. Such a contractual right, however, does not change the fact that Inland violated § 2607(a) by paying Premiere a fee for "directing," *i.e.*, referring, the Culpeppers' business to a particular lender.[3]

E. The Yield Spread Premium Was Not Payment For Services [4]

Although Premiere provided valuable services to the Culpeppers, the yield spread premium was not payment for those services for two reasons. First, the Culpeppers compensated Premiere by paying a 1% loan origination fee. No evidence suggests that this $760.50 payment was not

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[3] If the right to "direct" business constitutes sufficient "ownership" of that business to result in a "sale" of goods, virtually any referral in exchange for a fee could be characterized as an exempt sale of goods under § 2607(c), and RESPA's prohibition against referral fees would be nullified.

[4] On summary judgment, Inland argued that the yield spread premium was either a payment for goods or a payment for services. The district court did not reach the services argument, but Inland raises it on appeal as an alternative basis for upholding the district court's ruling.

intended by both Premiere and the Culpeppers to compensate Premiere fully for the work it did for the Culpeppers. Second, Inland stated in response to interrogatories that the yield spread premium "was paid to Premiere Mortgage [in part] for the slightly above-par yield on the mortgage note and [in part] for the right to service the loan." (R.1-16, ex. A at 5.) This response contradicts the theory that the yield spread premium compensated Premiere for its services to the Culpeppers.[5]

Similarly, the yield spread premium was not compensation for Premiere's providing services to Inland. In addition to the above interrogatory response, it is undisputed that the payment of the yield spread premium was not tied to the quantity or quality of the services that Premiere provided. Rather, the sole determinant of whether a yield spread premium would be paid was the interest rate on the loan. Stated another way, Premiere expends the same amount of effort and provides the same quality and quantity of services whether it originates an above par loan, a par loan, or a below par loan. Because Premiere receives a yield spread premium only when it originates an above par loan, the premium cannot be characterized as payment for originating the loan.

Based on the undisputed evidence, the only "service" for which the yield spread premium was compensation was Premiere's "service" of referring an above par loan to Inland. However, referring loan business, even valuable business, is not a service for which RESPA permits payment. The yield spread premium payment thus violated RESPA.

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[5] Mortgage transactions are structured in a variety of ways, and the holding here is highly dependent upon the facts of this financial transaction. We simply note that the particular facts here do not support the conclusion that the yield spread premium in this case was paid as compensation for the services Premiere provided to the Culpeppers.

F. RESPA's Market Value Test Is Inapplicable

RESPA's implementing regulations provide a test to determine whether a payment for a good or service is so excessive that part of the payment actually may constitute a prohibited referral fee.[6] Citing this test, the district court found that the payment Inland made to Premiere was a fair market price for the Culpeppers' loan and thus concluded that there was "no 'excess' payment left to be attributed to a 'referral fee.'" *Culpepper v. Inland Mort. Corp.*, 953 F.Supp. 367, 372 (N.D.Ala. 1997). This conclusion ignores the fact that the payment did not compensate Inland for any good or service. The market value test is useful only if the payment is for a good or service in the first instance and a determination must be made whether the payment is so excessive that the excess should be characterized as a referral fee. Here, Inland paid Premiere only for the referral of the loan. Thus, the market value test is inapplicable.

Inland stresses that market forces drive the size of yield spread premiums. This fact does not affect our analysis because the size of kickbacks and referral fees often is shaped by the value of the referred business. A market driven referral fee is still a referral fee prohibited by RESPA.

G. Denial Of Class Certification

Pursuant to Inland's request, the district court delayed consideration of the class certification issue until after resolving the motion for summary judgment. Having granted summary judgment in Inland's favor, the district court dismissed the class allegations without prejudice and denied the Culpeppers' motion for class certification without

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[6] The regulation states: "If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 C.F.R. § 3500.14(g)(2).

reaching the merits under Federal Rule of Civil Procedure 23. In light of our above reversal, we vacate the district court's denial of the motion for class certification and dismissal of the class claims and remand so that the district court can consider these issues *ab initio*.

III. CONCLUSION

Under the particular facts here, the yield spread premium Inland paid to Premiere was a prohibited referral fee under RESPA. Therefore, we REVERSE the district court's grant of summary judgment for Inland and REMAND for further proceedings consistent with this opinion. We also VACATE the district court's dismissal of the class claims and denial of class certification and REMAND for consideration under Rule 23.

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 97-6109

John Robert Culpepper, Patricia Starnes Culpepper, On Behalf Of Themselves And, All Similarly Situated Persons, Plaintiffs-Appellants,

v.

Inland Mortgage Corporation, Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Alabama

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June 22, 1998

Before EDMONDSON and HULL, Circuit Judges, and CLARK, Senior Circuit Judge.

OPINION

HULL, Circuit Judge:

The Petition for Rehearing is DENIED and no member of this panel nor other Judge in regular active service of the court having requested that the court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure;

Eleventh Circuit Rule 35-5), the Suggestion of Rehearing En Banc is DENIED.

Although the Petition is denied, we address several concerns raised by Petitioner Inland Mortgage to facilitate further proceedings. Inland's Petition first contends that this court held that RESPA prohibits the payment of all reasonable yield spread premiums by mortgage lenders to mortgage brokers who actually furnish services or goods and thereby precludes buyers from financing closing costs through yield spread premiums. This contention inaccurately describes our decision.

The central issue presented by this litigation is not whether yield spread premium payments by a mortgage lender can ever be lawful; they can in certain circumstances. The only issue decided by the court was whether as a matter of law Inland had proven in the instant record that this yield spread premium for this table-funded loan was a payment for goods or services and therefore not a prohibited referral fee.[1] As emphasized in footnote 5 of the opinion, our decision was highly dependent upon the facts in the current record about this table-funded financial transaction.

For example, one problem for Inland at the summary judgment stage in this case was that the evidence developed to date did not tie the yield spread premium to services provided by Premiere for Inland or for the Culpeppers. Instead, as our opinion noted, the evidence showed that the Culpeppers paid a 1% fee for broker services directly to Premiere and that the quality and quantity of Premiere's services, for Inland and the Culpeppers, were the same

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[1] While this table-funded loan was not a good that Premiere owned and sold to Inland, Inland is correct in asserting that RESPA would not have prevented Premiere from funding and then selling the Culpeppers' loan. As Inland's brief makes clear, however, that is not what happened in this case. Rather, Inland table-funded the transaction and paid a fee to Premiere for "the slightly above-par yield on the mortgage note and for the right to service the loan." Inland's Responses to Interrogatories, R.1-16, ex. A at 5.

irrespective of whether the interest rate was at par or above par. Inland's payment of the yield spread premium in this record appeared to be tied only to Premiere's referring an above par loan. Inland now claims that the yield spread premium also represented additional payment for Premiere's services to Inland and the Culpeppers, but the evidence before the district court at the summary judgment stage did not show this.

Second, Inland is concerned that our opinion summarily adjudicates the case in the Culpeppers' favor. The Culpeppers did not move for summary judgment, and our opinion resolves only whether the district court properly granted summary judgment to Inland. Thus, we clarify that Inland's inability to obtain judgment as a matter of law on the current record does not prevent Inland, on remand, from attempting to prove its case at trial. Nonetheless, we note that certain facts about the nature of this financial transaction seem to be undisputed which, at a minimum, presents a hurdle for Inland at trial.

Third, Inland contends that our opinion creates a series of "economic[] anomalies" because we read RESPA to prohibit certain transactions but not others. We are duty-bound to apply RESPA as written to determine whether, under the facts of this case, Inland's payment of a yield spread premium was lawful. Whether, as a matter of policy, RESPA should be amended to remove yield spread premiums from the statute's purview is an issue that we are not empowered to resolve. Thus, we leave it to Inland and other interested parties to pursue that issue before Congress and HUD.

PETITION FOR REHEARING AND SUGGESTION OF REHEARING EN BANC DENIED

APPENDIX F

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DISTRICT

No. CV96-H-917-S.

John Robert Culpepper & Patricia Starnes Culpepper,
Plaintiffs,

v.

Inland Mortgage Corporation, Defendant.

Jan. 31, 1997

MEMORANDUM OF DECISION

HANCOCK, Senior District Judge.

Presently before the Court is the November 26, 1996 motion for summary judgment filed by defendant, Inland Mortgage Corporation. Pursuant to the Court's December 2, 1997 Order, the motion was deemed submitted, without oral argument, on January 10, 1997. On January 17, 1997, Inland filed motions requesting leave to amend its evidentiary submission and requesting leave to file a reply brief. The Court granted both of these motions on January 21, 1997. In addition, on January 21, 1997, the Court entered

an Order requesting a document from the parties that was omitted from Inland's evidentiary submission.

I. Procedural History

Plaintiff John and Patricia Culpepper commenced this action by filing a complaint in this Court on April 11, 1996. The complaint alleged that Inland had violated the Real Estate Settlement Procedures Act of 1974 ("RESPA") in two ways: (1) by paying an impermissible "referral fee" or "kickback" to the Culpeppers' mortgage broker, Premiere Mortgage Company, and (2) by failing to disclose certain charges on the HUD-1 statement. The complaint sought class certification of its claims under Rule 23(b)(3), Fed.R.Civ.P.

A scheduling conference was held on August 12, 1996, and by an Order entered the following day, the Court acknowledged that plaintiffs' counsel had stated at the conference that plaintiffs did not intend to pursue any claim based on the failure to disclose information on the HUD-1 form. Rather, as the Court's Order notes, plaintiffs' counsel indicated that the only claim to be litigated was whether Inland's payment of a "yield spread premium" to Premiere was a "kickback" in violation of 12 U.S.C. § 2607(a). Plaintiffs filed a motion for leave to amend their complaint to delete any reference to a disclosure-based claim shortly thereafter, which motion was granted by the Court on December 2, 1996.[1]

Also at the August 12, 1996 scheduling conference, the defendants expressed a desire to test the sufficiency of plaintiffs' individual claims before any decision was made on the class certification issue. The Court agreed to this course of action, and stayed discovery on class certification issues

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[1] Apparently, plaintiffs never actually filed an amended complaint, but the parties have proceeded under the assumption that the only claim remaining in the case is plaintiffs' § 2607 claim.

pending the resolution of Inland's motion for summary judgment. *See* August 13, 1996 Order.

II. Standards for Evaluating a Summary Judgment Motion

Under Fed.R.Civ.P. 56(c), summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *See Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986). The party asking for summary judgment always bears the initial responsibility of informing the court of the basis for its motion, and identifying those portions of the pleadings or filings, which it believes demonstrate the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323, 106 S.Ct. at 2552-53. Once the moving party has met his burden, Rule 56(e) requires the nonmoving party to go beyond the pleadings and by his own affidavits, or by the depositions, answers to interrogatories, and admissions of file, designate specific facts showing that there is a genuine issue for trial. *Celotex*, 477 U.S. at 324, 106 S.Ct. at 2553.

The substantive law will identify which facts are material and which are irrelevant. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). All reasonable doubts about the facts and all justifiable inferences are resolved in favor of the non-movant. *Fitzpatrick v. City of Atlanta*, 2 F.3d 1112, 1115 (11th Cir. 1993). A dispute is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson*, 477 U.S. at 248, 106 S.Ct. at 2510. If the evidence is merely colorable, or is not significantly probative, summary judgment may be granted. *Id.* at 249, 106 S.Ct. at 2510-11.

The method used by the party moving for summary judgment to discharge its initial burden depends on whether that party bears the burden of proof on the issue at trial. *See Fitzpatrick*, 2 F.3d at 1115-17 (citing *United States v. Four Parcels of Real Property*, 941 F.2d 1428 (11th Cir. 1991) (*en banc*)). If the moving party bears the burden of proof at trial, then it can only meet its initial burden on summary judgment by coming forward with positive evidence demonstrating the absence of a genuine issue of material fact; i.e. facts that would entitle it to a directed verdict if not controverted at trial. *Fitzpatrick*, 2 F.3d at 1115. Once the moving party makes such a showing, the burden shifts to the non-moving party to produce significant, probative evidence demonstrating a genuine issue for trial.

If the moving party does not bear the burden of proof at trial, it can satisfy its initial burden on summary judgment in either of two ways. First, the moving party may produce affirmative evidence negating a material fact, thus demonstrating that the non-moving party will be unable to prove its case at trial. Once the moving party satisfies its burden using this method, the non-moving party must respond with positive evidence sufficient to resist a motion for directed verdict at trial.

The second method by which the moving party who does not bear the burden of proof at trial can satisfy its initial burden on summary judgment is to *affirmatively* show the absence of evidence in the record to support a judgment for the non-moving party on the issue in question. This method requires more than a simple statement that the non-moving party cannot meet its burden at trial but does not require evidence negating the non-movant's claim; it simply requires the movant to point out to the district court that there is an absence of evidence to support the non-moving party's case. *Fitzpatrick*, 2 F.3d at 1115-16. If the movant

meets its initial burden by using this second method, the non-moving party may either point out to the court record evidence, overlooked or ignored by the movant, sufficient to withstand a directed verdict, or the non-moving party may come forward with additional evidence sufficient to withstand a directed verdict motion at trial based on the alleged evidentiary deficiency. However, when responding, the non-movant can no longer rest on mere allegations, but must set forth evidence of specific facts. *Lewis v. Casey*, 518 U.S. 343, 116 S.Ct. 2174, 135 L.Ed.2d 606 (1996).

III. Relevant Undisputed Facts

The parties agree on all of the relevant facts in this case, although they naturally draw contrary legal conclusions from those facts. Inland Mortgage Corporation is a mortgage lender and servicer based in Indianapolis, Indiana. Premiere Mortgage Company is a Birmingham, Alabama mortgage broker. (Blankensopp Aff.). By an agreement dated March 15, 1994, Premiere and Inland agreed that, from time to time, Inland would purchase loans originated by Premiere. (*Id.*, Ex. U). Premiere, however, would not furnish the capital for these loans; instead, Premiere would "register" loans with Inland, and Inland would supply the loan proceeds to Premiere. (*Id.*).[2] After the loan was consummated, Premiere would then be obligated to deliver the loan "package" to Inland, including the promissory note, mortgage, evidence of insurance, and assignments of all

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[2] The parties agree that this arrangement is known as "table funding," and that it was not a "secondary market transaction" exempt from the requirements of RESPA. *See* 24 C.F.R. § 3500.2. The "table funding" of loans simply absolved Inland from having to compensate Premiere for the use of Premiere's capital; if Premiere had closed loans using its own capital, any sale of the loans would have included a fee for the use of that capital. The "table funding" arrangement was thus beneficial to both parties—to Premiere because it did not have to raise the capital and to Inland because it could likely obtain capital more cheaply than Premiere could.

rights Premiere held. (*Id.*). The contract further provided that Inland would compensate Premiere for these loan purchases in accordance with Inland's "Pricing Policy and Procedures." (*Id.*).[3]

Inland's "Pricing Policy and Procedures" recited that Inland would distribute "established daily prices" each day at 11:00 a.m. Eastern time, and that it would continue to honor those prices until 9:30 a.m. the following day. (Defendant's 1/30/97 Notice of Filing Evidentiary Materials).

In keeping with its contracts with Premiere and other mortgage brokers, Inland released daily price sheets showing the "prices" it was willing to pay for various loans. (Acree Aff.). The "price" was expressed as a percentage of the loan amount, and was influenced by factors such as the type of loan, the "lock-in" period, and the interest rate on the loan. (*Id.*). For a loan of "par value," Inland paid nothing to the broker; for "below par" loans, Inland required the broker to pay "discount points" to Inland; and for "above par" loans, Inland paid the broker a "yield spread premium." (*Id.*). The undisputed evidence in the record

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[3] Paragraph 1 of the Inland-Premiere "Loan Purchase Agreement" attached as Exhibit U to the Blankensopp affidavit, reads in relevant part as follows:

> 1. **Commitment to purchase loans**. Seller may from time to time register loans with the marketing department of Inland for eventual sale to Inland. The price to be paid for any loans so registered, the time period during which Inland honors a given price, and all other issues related to the pricing of loans will be determined by Inland's Pricing Policy and Procedures, a copy of which is attached to this agreement and incorporated into this agreement by this reference .... By accepting registration of a loan, Inland agrees to purchase said loan from seller, provided that the price and delivery of the loan complies with Inland's pricing policy and all provisions of this agreement and the Inland Wholesale Lending Manual. ...

indicates that Inland's prices were set by market forces, such as the cost of capital, competitors' prices, and other economic factors. (*Id.*).

The Culpeppers contacted Premiere on October 30, 1995, to inquire about the possibility of obtaining a mortgage loan through Premiere. (Blankensopp Aff.). The Culpeppers went through the loan application process, and later found a home to purchase. (*Id.*). On December 7, 1995, the Culpeppers chose to "lock in" the 7.5% interest rate that Premiere was offering at that time. (*Id.*).[4] On that same day, Premiere "registered" the Culpeppers' loan with Inland. (*Id.*). The loan closed on December 15, 1995, and Premiere acted as the lender during closing. (*Id.*). Shortly after the loan closing, Premiere, in accordance with its contract with Inland, executed assignments of the Culpeppers' note and mortgage to Inland. (*Id.*, Exs. W & X).

The HUD-1 statement given to the Culpeppers at the closing showed that the Culpeppers paid Premiere a 1% origination fee ($760.50) for Premiere's services. (Acree Aff., Ex. B). In addition, Premiere received a $1263.61 "yield spread premium" from Inland, which was also disclosed on the HUD-1 form. (*Id.*). The amount of the yield spread premium was calculated as follows: consulting Inland's price sheet for December 7, 1995 (the Culpeppers' "lock-in" date), under the category "Government Products—30 year fixed," the Culpeppers' loan was a 7.5% loan with a 15-day "lock-in" period, yielding a figure of -1.375. (Acree Aff., Ex. A). An additional .25 was subtracted, due to the fact that the amount of the Culpeppers' loan exceeded $50,000. (*Id.*). Adding these figures yielded -1.625, which

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[4] The Blankensopp Affidavit establishes as undisputed fact that the 7.5% rate obtained by the Culpeppers was a competitive market rate for a loan like the Culpeppers' in the Birmingham area market on December 7, 1995.

was the percentage yield spread premium Inland paid to Premiere. (*Id.*).[5]

IV. Applicable Substantive Law and Analysis

The Real Estate Settlement Procedures Act of 1974 ("RESPA"), among other things, prohibits providers of "settlement services" from paying "referral fees" or "kickbacks":

> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

12 U.S.C. § 2607(a). Although the funding and origination of mortgage loans was not originally a "settlement service" as defined by RESPA, a 1992 amendment made it clear that such activities were "settlement services" subject to the Act's requirements. *See* 12 U.S.C. § 2602(3).

Here, the Culpeppers' claim is that the yield spread premium paid by Inland to Premiere was a "referral fee" proscribed by § 2607(a). In other words, the Culpeppers argue that Inland paid Premiere the yield spread premium in exchange for Premiere "referring" the Culpeppers' loan to Inland, so that Inland could provide the "settlement service" of funding the loan.

Inland argues, by contrast, that the yield spread premium was simply the market-driven payment to Premiere for an asset—the loan itself. Inland relies on an exception to § 2607(a), which reads as follows:

> Nothing in this section shall be construed as prohibiting ... (2) the payment to any person of a

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[5] The Culpeppers' loan amount was $77,761.00. Multiplying that figure by 1.625% produced a yield spread premium of $1,263.61.

> bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.

12 U.S.C. § 2607(c). Inland characterizes the yield spread premium as "payment for goods," that is, the purchase price of the Culpeppers' loan.

In determining whether the yield spread premium was an illegal "referral fee" or a permissible "payment for goods," the Court looks to the interpretation of RESPA provided by Regulation X, 24 C.F.R. part 3500. Plaintiffs argue that the yield spread premium paid by Inland to Premiere was an inducement designed to influence Premiere's selection of Inland for the funding of the Culpeppers' loan. Plaintiffs in particular point to the definition of "agreement or understanding" contained in 24 C.F.R. § 3500.14(e): "[w]hen a thing of value is received repeatedly and is connected in any way with the volume *or value* of the business referred, the receipt of the thing of value is evidence that it is made pursuant to an agreement or understanding for the referral of business" (emphasis added). Tracking this regulatory language, plaintiffs argue that, because the yield spread premium was tied to the value of the Culpeppers' loan to Inland, it was a referral fee as proscribed by § 2607.

Plaintiffs' argument, although superficially appealing, does not withstand scrutiny, because the undisputed evidence in the record indicates that the premium paid to Premiere was a market-driven purchase price that Inland paid for the Culpeppers' loan. *See* Acree Aff. This purchase price was no more a "referral fee" that induced Premiere's selection of Inland than any other purchase price induces a seller to part with property in exchange for money. In fact, because the record here indicates without dispute that the yield spread premium was reflection of the fair market value of plaintiffs' loan, it meets the test enunciated in Regulation

X for determining whether a fee is a payment for purchase of goods or services: "[i]f the payment ... bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 C.F.R. § 3500.14(g)(2).[6] There is also no dispute on the record that Premiere, wholly apart from the settlement services it provided the Culpeppers, created a valuable asset for Inland, and the payment from Inland to Premiere reflected the value of that asset. Because the only payment from Inland to Premiere, as a matter of undisputed fact, was a fair market price for the Culpeppers' loan, there is no "excess" payment left to be attributed to a "referral fee."

Plaintiffs argue, however, that the yield spread premium cannot be a payment for the purchase of a loan, because Inland would be obligated to pay nothing for "buying" a par or below-par loan. Plaintiffs' argument misunderstands the consideration flowing from Inland to Premiere by viewing the yield spread as the only consideration given to Premiere. First and foremost among the consideration furnished to Premiere by Inland is Inland's promise to provide capital for Premiere to lend and Inland's promise to take on loans generated by Premiere. Without a doubt, these promises are extremely valuable to Premiere, because the availability of capital and a lender willing to purchase loans make Premiere's operation possible. More importantly, as a broker representing borrowers, Premiere is entitled to charge home buyers fees for its services—

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[6] The Court notes that whether Premiere requires borrowers to pay to it any amount it will owe to Inland when a loan is below par, and whether Premiere passes along to the borrower any yield spread premium it receives for an above-par loan, are irrelevant to the decision that, in either case, the purchase price for the loan is totally determined by market forces. In other words, Premiere's disposition of the yield spread has no bearing on the issue of how to characterize the payment from Inland to Premiere.

origination fees, fees for appraisals, and the like. Inland's commitment to purchase loans and supply capital thus makes it possible for Premiere to do business and make a profit from its borrower customers. This commitment of capital by Inland is thus the primary consideration or "purchase price" for loans generated by Premiere, and the discount points or yield spread premiums simply adjust that consideration upward or downward based on the loan's fair market value at the time it is "registered."[7] Viewed in this context, it is clear that the price sheets' entries regarding discount points and yield spread premiums for loans above and below par is simply an adjustment to the overall consideration Inland gives to Premiere for the purchase of loans generated by Premiere.

To conclude, on the undisputed facts of this case, the yield spread premium paid by Inland to Premiere was a fair market value paid to Premiere in exchange for Premiere's creation of the Culpepper loan and sale of that loan to Inland. Although the yield spread premium could fit within the definition of a referral fee, it also undoubtedly fits within the definition of a permitted "payment for goods" under § 2607(c)(2). By the structure of the statute itself, the specific exceptions to liability contained in § 2607(c) override the general prohibitory language contained in § 2607(a). Thus, even if plaintiffs are correct that the yield spread premium technically falls within the definition of a "referral fee," the more specific exception for "payment for goods" in § 2607(c) renders the premium permissible as a matter of law. Inland's motion for summary judgment is due to be granted, and an Order to that effect will be entered.[8]

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[7] *See supra* footnote 5.

[8] The Court acknowledges that it reaches a different result than some other courts that have addressed the permissibility of yield spread premiums under RESPA. In *Mentecki v. Saxon Mortgage, Inc.*, No. 96-1629-A, 1997 WL 45088 (E.D.Va. Jan. 10, 1997), the Court denied a

Also pending before the Court is the January 15, 1997 motion for class certification filed by plaintiffs. At defendants' request, the Court delayed reaching the class certification issue until after the resolution of the present motion for summary judgment. The Court believes that, in this case, it is proper to enter judgment on defendant's behalf and simply dismiss the class allegations without prejudice. The absent class members certainly suffer no prejudice from this course of action--since no class was ever certified, the absent class members are not bound by this judgment and remain free to bring their own claims to court. And, given the Court's holding that plaintiffs' claims fail as a matter of law, the only party (other than the Culpeppers) to suffer prejudice is the defendant, who loses the opportunity to obtain a favorable judgment against the entire class. However, since Inland asked for this treatment, the prejudice it suffers will not be considered. In addition, delaying the massive cost associated with discovery and administration of a class action until after the named plaintiffs' claims survive a motion for summary judgment serves to eliminate unnecessary costs to the Court and the parties. In these circumstances, the Court exercised its discretion to delay the class certification issue. And, now that the Court has determined that Inland is entitled to

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12(b)(6) motion in a yield spread case brought under RESPA. However, the present case differs from *Mentecki* in two respects: (1) here, there was an unrebutted evidentiary showing that the yield spread was determined by market forces, and (2) here, unlike in *Mentecki*, defendant argues that the yield spread premium was a payment for the broker's sale of loans to the lender. No such argument was addressed in *Mentecki*. In addition, the Court notes that Judge Ryskamp, in *Martinez v. Weyerhauser Mortgage Co.*, No. 94-1610 (S.D. Fla. Aug. 30, 1996), denied a motion for summary judgment filed by defendants in yet another RESPA yield spread case. However, *Martinez*, like *Mentecki*, did not address the argument that a yield spread premium is part of the payment a lender makes for the purchase of loans. Thus, neither *Mentecki* nor *Martinez* are persuasive here.

judgment as a matter of law, the fairest course is simply to dismiss the class allegations without prejudice. Thus, plaintiffs' January 15, 1997 motion for class certification will be denied.

APPENDIX G

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

Consolidated Case No.
CV 96-BU-917-S

John Robert Culpepper & Patricia Starnes Culpepper, et al.,
Plaintiffs,

v.

Inland Mortgage Corporation, Defendant.

Consolidated Case No.
CV 98-BU-2187-S

BEATRICE N. HEIRS, individually and as a representative of a class of similarly situated persons, Plaintiffs,

v.

IRWIN MORTGAGE CORPORATION f/d/b/a INLAND MORTGAGE CORPORATION, Defendant.

[Filed: Oct. 31, 2001. Entered: Oct. 31, 2001]

ORDER

In the above-styled consolidated actions, John and Patricia Culpepper and Beatrice Hiers bring claims alleging

that Defendant Irwin Mortgage Corporation, f/k/a Inland Mortgage Corporation has violated § 8 of the Real Estate Settlement Procedures Act, 12 U.S.C. § 2607 ("RESPA"), based upon its practice of paying "yield spread premiums" to mortgage brokers. The Court has certified a class action pursuant to Fed. R. Civ. P. 23(b)(3). Now pending is Plaintiffs' motion for partial summary judgment, seeking to establish Irwin's class-wide liability. (Doc. 86).

On October 30, 2001, Irwin presented to the Court as supplemental legal authorities (1) the "RESPA Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule," 66 Fed. Reg. 53052 (October 18, 2001) (2001 Policy Statement); and (2) an order granting summary judgment for the defendants in Bjustrom v. Trust One Mortgage, No. C00-1166P (W.D. Wash. October 26, 2001). The Court hereby ORDERS Plaintiffs and Irwin to file, ON OR BEFORE NOVEMBER 14, 2001, supplemental briefs analyzing the import of these two authorities, with the emphasis on the 2001 Policy Statement. As the 2001 Policy Statement clearly indicates that it would abrogate the Eleventh's Circuit's holdings in Culpepper v. Irwin Mortgage Corp., 253 F.3d 1324 (11th Cir. 2001), with regard to both the substantive rules of liability under RESPA § 8 and the propriety of class certification of such claims generally, the parties would do well to focus on the extent to which the 2001 Policy Statement is binding on this Court. In particular, the parties should include discussions on the potential applicability of the law-of-the-case doctrine and whether the 2001 Policy Statement is due deference under Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

IT IS SO ORDERED, this 31st day of October, 2001.

/s/ H. Dean Buttram, Jr.
H. DEAN BUTTRAM, JR.
UNITED STATES DISTRICT JUDGE

APPENDIX H

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 99-13725-TT

96-cv-917

John Robert Culpepper, Patricia Starnes Culpepper, on behalf of themselves and all others similarly situated, Plaintiffs-Appellees

v.

Irwin Mortgage Corporation, f.k.a Inland Mortgage Corporation, Defendant-Appellant

98-cv-2187

Beatrice N. Hiers, individually and as a representative of a class of similarly situated persons, Plaintiff-Appellee,

v.

Irwin Mortgage Corporation, f.k.a. Inland Mortgage Corporation, Defendant-Appellant.

On Appeal from the United States District Court for the Northern District of Alabama

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[Filed: August 15, 2001]

ON PETITION(S) FOR REHEARING AND PETITION(S) FOR REHEARING EN BANC

(Opinion _____, 11th Cir., 19__, ___ F.2d ___).

Before: EDMONDSON, COX and GIBSON*, Circuit Judges.

PER CURIAM:

The Petition(s) for rehearing are DENIED and no member of this panel nor other Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Petition(s) for Rehearing are DENIED.

ENTERED FOR THE COURT:

/s/ Emmett R. Cox

UNITED STATES CIRCUIT JUDGE

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* Honorable John R. Gibson, U.S. Circuit Judge for the Eighth Circuit, sitting by designation.

APPENDIX I

12 U.S.C. § 2607 - Prohibition against kickbacks and unearned fees

(a) **Business referrals.** No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

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(c) **Fees, salaries, compensation, or other payments.** Nothing in this section shall be construed as prohibiting (1) the payment of a fee (A) to attorneys at law for services actually rendered or (B) by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance or (C) by a lender to its duly appointed agent for services actually performed in the making of a loan, (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed, or (3) payments pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and brokers, (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred (i) in the case of a face-to-face referral or a referral made in writing or by electronic media, at or before the time of the referral (and compliance with this requirement in such case may be evidenced by a notation in a written, electronic, or similar system of records maintained

in the regular course of business); (ii) in the case of a referral made by telephone, within 3 business days after the referral by telephone, (and in such case an abbreviated verbal disclosure of the existence of the arrangement and the fact that a written disclosure will be provided within 3 business days shall be made to the person being referred during the telephone referral); or (iii) in the case of a referral by a lender (including a referral by a lender to an affiliated lender), at the time the estimates required under section 5(c) are provided (notwithstanding clause (i) or (ii)); and any required written receipt of such disclosure (without regard to the manner of the disclosure under clause (i), (ii), or (iii)) may be obtained at the closing or settlement (except that a person making a face-to-face referral who provides the written disclosure at or before the time of the referral shall attempt to obtain any required written receipt of such disclosure at such time and if the person being referred chooses not to acknowledge the receipt of the disclosure at that time, that fact shall be noted in the written, electronic, or similar system of records maintained in the regular course of business by the person making the referral), (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship, or (5) such other payments or classes of payments or other transfers as are specified in regulations prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture. For purposes of the preceding sentence, the following shall not be considered a violation of clause (4)(B): (i) any arrangement that requires a buyer, borrower, or seller to pay for the services of an attorney,

credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest in a real estate transaction, or (ii) any arrangement where an attorney or law firm represents a client in a real estate transaction and issues or law firm represents a client in a real estate transaction and issues or arranges for the issuance of a policy of title insurance in the transaction directly as agent or through a separate corporate title insurance agency that may be established by that attorney or law firm and operated as an adjunct to his or its law practice.

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12 U.S.C. § 2617. Authority of the Secretary

(a) The Secretary is authorized to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this Act.

(b) No provision of this Act or the laws of any State imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, or interpretation thereof by the Secretary or the Attorney General, notwithstanding that after such act or omission has occurred, such rule, regulation, or interpretation is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

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APPENDIX J

24 C.F.R. § 3500.4 – Reliance upon rule, regulation or interpretation by HUD.

(a) *Rule, regulation or interpretation.* (1) For purposes of sections 19 (a) and (b) of RESPA (12 U.S.C. 2617 (a) and (b)) only the following constitute a rule, regulation or interpretation of the Secretary:

(i) All provisions, including appendices, of this part. Any other document referred to in this part is not incorporated in this part unless it is specifically set out in this part;

(ii) Any other document that is published in the FEDERAL REGISTER by the Secretary and states that it is an "interpretation," "interpretive rule," "commentary," or a "statement of policy" for purposes of section 19(a) of RESPA. Such documents will be prepared by HUD staff and counsel. Such documents may be revoked or amended by a subsequent document published in the FEDERAL REGISTER by the Secretary.

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24 C.F.R. § 3500.14 – Prohibition against kick-backs and unearned fees.

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(g) *Fees, salaries, compensation, or other payments.* (1) Section 8 of RESPA permits:

(i) A payment to an attorney at law for services actually rendered;

(ii) A payment by a title company to its duly appointed agent for services actually performed in the issuance of a policy of title insurance;

(iii) A payment by a lender to its duly appointed agent or contractor for services actually performed in the origination, processing, or funding of a loan;

(iv) A payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed;

(v) A payment pursuant to cooperative brokerage and referral arrangements or agreements between real estate agents and real estate brokers. (The statutory exemption restated in this paragraph refers only to fee divisions within real estate brokerage arrangements when all parties are acting in a real estate brokerage capacity and has no applicability to any fee arrangements between real estate brokers and mortgage brokers or between mortgage brokers.);

(vi) Normal promotional and educational activities that are not conditioned on the referral of business and that do not involve the defraying of expenses that otherwise would be incurred by persons in a position to refer settlement services or business incident thereto; or

(vii) An employer's payment to its own employees for any referral activities.

(2) The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. The fact that the transfer of the thing of value does not result in

an increase in any charge made by the person giving the thing of value is irrelevant in determining whether the act is prohibited.

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APPENDIX K

64 Federal Register 10,080

FEDERAL REGISTER

Monday, March 1, 1999

Rules and Regulations

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-4450-N-01]

RIN 2502-AH33

Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers

AGENCY: Office of the Assistant Secretary for Housing–Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1999-1.

SUMMARY: This Statement of Policy sets forth the Department of Housing and Urban Development's position on the legality of lender payments to mortgage brokers in connection with federally related mortgage loans under the

Real Estate Settlement Procedures Act ("RESPA") and HUD's implementing regulations. While this statement satisfies the Conferees' directive in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on this subject, HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and the Truth in Lending Act (TILA) for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules. Such an approach is far preferable to piecemeal actions.

EFFECTIVE DATE: This Statement of Policy is effective March 1, 1999.

FOR FURTHER INFORMATION CONTACT: Rebecca J. Holtz, Director RESPA/ILS Division Room 9146, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-4560, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA or Rodrigo Alba, Attorney for RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone 202-708-3137 (these are not toll free numbers). Hearing or speech-impaired individuals may access these numbers via TTY by calling the toll-free Federal Information Relay Service at 1-800-877-8339.

SUPPLEMENTARY INFORMATION: This Preamble to the Statement of Policy includes descriptions of current practices in the industry. It is not intended to take positions with respect to the legality or illegality of any

practices; such positions are set forth in the Statement of Policy itself.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA)]" (Id.). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (Id.).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues

concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (See 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be presumed legal if the mortgage broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report containing legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who

funded the loan. The rise in technology permitted much more effective and faster exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship with the borrower and, in some states, may be found to owe a responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services

under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (e.g., 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or "yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time. The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points).[1] In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan rates for borrowers and/or that this compensation system is illegal under RESPA.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves.[2] Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the

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[1] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

[2] In many instances, these loans are called "no cost" or "no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services'" (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a *bona fide* transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions

subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93-866 (1974) *reprinted in* 1974 U.S.C.C.A.N. 6548). Section 2 of the Act provides:

> "significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result-
>
> in more effective advance disclosure to home buyers and sellers of settlement costs; [and]
>
> (2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * *" 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific

settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD-VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93-866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the part of most home buyers about the settlement process and its costs, which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress

sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93-866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices"—kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93-866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section [8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished" were not intended to be prohibited (Id).[3] It also provided that "[t]hose persons

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[3] One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient services are provided, RESPA is intended to prohibit payment.

and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (*Id.*)

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan. (Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992; 104 Stat. 4413). At the same time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (*Id.*)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lender-paid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in

arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums" and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of *per se* legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided.* These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services

actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in the transaction, before the consumer

applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that did not exceed a test, to be established in the rulemaking, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers' fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the

mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with estimated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy.

Under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the

Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105-769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield

spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR § 3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real

source of funds (i.e., table-funded transactions or transactions involving "intermediary" brokers). In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. Payments Must Be for Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. In making the determination of whether compensable services are performed, HUD's letter to the Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application;[4]

(b) Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

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[4] In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as compensable under RESPA, they should be identifiable and

meaningful services akin to those identified in the IBAA letter including, for example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and
- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services—(b), (c), (d), (j), and (k) on the list above—to justify its fee, HUD would also look to see that meaningful counseling-not steering-is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;
- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*
- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed.[5] However, the IBAA letter responded to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans.[6]

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary

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[5] In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only non-counseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

[6] In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $ 200.

market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.[7] If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the

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[7] HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93-866, at 6551.)

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the

mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there may be no

payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.)[8]

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24 CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount

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[8] The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (See 24 CFR 3500.14(e).)

of compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted.[9] Also, the Department has seen examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the mortgage broker should identify that they are mortgage broker fees from the borrower.[10]

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[9] This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

[10] HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if these additional disclosures were included in future forms.

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to the interest rate and points for the loan and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-

application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this Statement of Policy under Executive Order 12866, *Regulatory Planning and Review.* OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: February 22, 1999.

William C. Apgar,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 99-4921 Filed 2-26-99; 8:45 am]
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APPENDIX L

66 Federal Register 53,052

FEDERAL REGISTER

Thursday, October 18, 2001

Rules and Regulations

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 3500

[Docket No. FR-4714-N-01]
RIN 2502-AH74

Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 2001-1.

SUMMARY: This Statement of Policy is being issued to eliminate any ambiguity concerning the Department's position with respect to those lender payments to mortgage brokers characterized as yield spread premiums and to overcharges by settlement service providers as a result of questions raised by two recent court decisions, *Culpepper v.*

Irwin Mortgage Corp. and *Echevarria v. Chicago Title and Trust Co.*, respectively. In issuing this Statement of Policy, the Department clarifies its interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) in Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers (March 1, 1999) (the 1999 Statement of Policy), and reiterates its long-standing interpretation of Section 8(b)'s prohibitions. *Culpepper v. Irwin Mortgage Corp.* involved the payment of yield spread premiums from lenders to mortgage brokers. *Echevarria v. Chicago Title and Trust Co.* involved the applicability of Section 8(b) to a settlement service provider that overcharged a borrower for the service of another settlement service provider, and then retained the amount of the overcharge.

Today's Statement of Policy reiterates the Department's position that yield spread premiums are not per se legal or illegal, and clarifies the test for the legality of such payments set forth in HUD's 1999 Statement of Policy. As stated there, HUD's position that lender payments to mortgage brokers are not illegal per se does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The legality of yield spread premiums turns on the application of HUD's test in the 1999 Statement of Policy as clarified today.

The Department also reiterates its long-standing position that it may violate Section 8(b) and HUD's implementing regulations: (1) for two or more persons to split a fee for settlement services, any portion of which is unearned; or (2) for one settlement service provider to mark-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) for one settlement service provider to charge the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of

the reasonable value of goods or facilities provided or the services actually performed.

This Statement of Policy also reiterates the importance of disclosure so that borrowers can choose the best loan for themselves, and it describes disclosures HUD considers best practices. The Secretary is also announcing that he intends to make full use of his regulatory authority to establish clear requirements for disclosure of mortgage broker fees and to improve the settlement process for lenders, mortgage brokers, and consumers.

EFFECTIVE DATE: October 18, 2001.

FOR FURTHER INFORMATION CONTACT: Ivy M. Jackson, Acting Director, RESPA/ILS Division, Room 9156, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410; telephone (202) 708-0502, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708-3137 (these are not toll-free numbers). Persons who have difficulty hearing or speaking may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

General Background

The Department is issuing this Statement of Policy in accordance with 5 U.S.C. 552 as a formal pronouncement of its interpretation of relevant statutory and regulatory provisions. Section 19(a) (12 U.S.C. 2617(a)) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601-2617) (RESPA) specifically authorizes the Secretary "to prescribe such rules and regulations [and] to make such interpretations * * * as may be necessary to achieve the purposes of [RESPA]."

Section 8(a) of RESPA prohibits any person from giving and any person from accepting "any fee, kickback, or thing of value pursuant to an agreement or understanding, oral or otherwise" that real estate settlement service business shall be referred to any person. See 12 U.S.C. 2607(a). Section 8(b) prohibits anyone from giving or accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service * * * other than for services actually performed." 12 U.S.C. 2607(b). Section 8(c) of RESPA provides, "Nothing in [Section 8] shall be construed as prohibiting * * * (2) the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed * * *" 12 U.S.C. 2607(c)(2). RESPA also requires the disclosure of settlement costs to consumers at the time of or soon after a borrower applies for a loan and again at the time of real estate settlement. 12 U.S.C. 2603-4. RESPA's requirements apply to transactions involving a "federally related mortgage loan" as that term is defined at 12 U.S.C. 2602(l).

I. Lender Payments to Mortgage Brokers

The Conference Report on the Department's 1999 Appropriations Act directed HUD to address the issue of lender payments to mortgage brokers under RESPA. The Conference Report stated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. sec. 2607) in its enactment of RESPA." H. Rep. 105-769, at 260. As also directed by Congress, HUD worked with industry groups, federal agencies, consumer groups and other interested parties in collectively producing the 1999 Statement of Policy issued on March 1, 1999. 64 FR 10080. Interested members of the public are urged to consult the 1999 Statement of Policy for a more detailed discussion of

the background on lender payments to brokers addressed in today's Statement.

HUD's 1999 Statement of Policy established a two-part test for determining the legality of lender payments to mortgage brokers for table funded transactions and intermediary transactions under RESPA: (1) Whether goods or facilities were actually furnished or services were actually performed for the compensation paid and; (2) whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to the goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. Where a lender payment to a mortgage broker comprises a portion of total broker compensation, the amount of the payment is not, under the HUD test, scrutinized separately and apart from total broker compensation.

Since HUD issued its 1999 Statement of Policy, most courts have held that yield spread premiums from lenders to mortgage brokers are legal provided that such payments meet the test for legality articulated in the 1999 Statement of Policy and otherwise comport with RESPA. However, in a recent decision, *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), the Court of Appeals for the Eleventh Circuit upheld certification of a class in a case alleging that yield spread premiums violated Section 8 of RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread

premiums to the brokers based solely on the brokers' delivery of above par interest rate loans. The court concluded that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender's payments were based exclusively on interest rate differentials reflected on rate sheets, and the lender had no knowledge of what services, if any, the broker performed. The court described HUD's 1999 Statement of Policy as "ambiguous." *Id.* at 1327. Accordingly, and because courts have now rendered conflicting decisions, HUD has an obligation to clarify its position and issues this Statement today to provide such clarification and certainty to lenders, brokers, and consumers.

Because this clarification focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exception.

II. Disclosure

Besides establishing the two-part test for determining the legality of yield spread premiums, the 1999 Statement of Policy discussed the importance of disclosure in permitting borrowers to choose the best loan for themselves. The mortgage transaction is complicated, and most people engage in such transactions relatively infrequently, compared to the other purchases they make. In some instances, borrowers have paid very large origination costs, either up front fees, yield spread premiums, or both, which they might have been able to avoid with timely disclosure. Timely disclosure would permit them to shop for preferable origination costs and mortgage terms and to agree to those

costs and terms that meet their needs. The Department therefore is issuing a clarification of the importance of disclosure, with a description of disclosures that it considers to be best practices.

In this Statement of Policy, the Secretary is announcing that he intends to make full use of his regulatory authority as expeditiously as possible to provide clear requirements and guidance prospectively regarding disclosure of mortgage broker fees and, more broadly, to improve the mortgage settlement process so that homebuyers and homeowners are better served. Pending the promulgation of such a rule, the Secretary asks the industry to adopt new disclosure requirements to promote competition and to better serve consumers.

III. Unearned Fees

The 1999 Statement of Policy also touched upon another area of recurring questions under Section 8 of RESPA: the legality of payments that are in excess of the reasonable value of the goods or facilities provided or services performed. See 64 FR 10082-3.

Since RESPA was enacted, HUD has consistently interpreted Section 8(b) and HUD's RESPA regulations to prohibit settlement service providers from charging unearned fees, as occurred in *Echevarria v. Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001). Such an interpretation is consistent with Congress's finding, when enacting RESPA, that consumers need protection from unnecessarily high settlement costs. Through this Statement of Policy, HUD makes clear that Section 8(b) prohibits any person from giving or accepting any fees other than payments for goods and facilities provided or services actually performed. Payments that are unearned fees occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider

marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In a July 5, 2001 decision, the Court of Appeals for the Seventh Circuit concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b). Accordingly, the court held that a settlement service provider did not violate Section 8(b) when, in billing a borrower, it added an overcharge to another provider's fees and retained the additional charge without providing any additional goods, facilities or services. *Echevarria v. Chicago Title & Trust Co.* Other courts have held that two or more parties must split or share a fee in order for a violation of Section 8(b) to occur. Still other courts have stated, however, that a single provider can violate Section 8(b). Because the courts are now divided, HUD is issuing this Statement of Policy to reiterate its interpretation of Section 8(b).

The Court of Appeals for the Seventh Circuit rendered its conclusion in *Echevarria* "absent a formal commitment by HUD to an opposing position. * * *" *Id.* at 630. In issuing this Statement of Policy pursuant to Section 19(a), HUD reiterates its position on unearned fees under Section 8(b) of RESPA, which HUD regards as long standing.

IV. Statement of Policy 2001-1

To give guidance to interested members of the real estate settlement industry and the general public on the application of RESPA and its implementing regulations, the Secretary hereby issues the following Statement of Policy. The interpretations embodied in this Statement of Policy are

issued pursuant to Section 19(a) of RESPA. 12 U.S.C. 2617(a).

Part A. Mortgage Broker Fees

Yield Spread Premiums

One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs is the up front cash needed to obtain a mortgage. The closing costs and origination fees associated with a mortgage loan are a significant component of these up front cash requirements. Borrowers may choose to pay these fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by financing them; *i.e.*, adding the amount of such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. For those without the available cash, who are at the maximum loan-to-value ratio, or who simply choose to do so, there is a third option. This third option is a yield spread premium.

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as "indirect" fees and are referred to as yield spread premiums.[1]

A yield spread premium is calculated based upon the difference between the interest rate at which the broker

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[1] "Indirect fees from lenders are also known as "back funded payments," "overages," or "servicing release premiums."

originates the loan and the par, or market, rate offered by a lender. The Department believes, and industry and consumers agree, that a yield spread premium can be a useful means to pay some or all of a borrower's settlement costs. In these cases, lender payments reduce the up front cash requirements to borrowers. In some cases, borrowers are able to obtain loans without paying any up front cash for the services required in connection with the origination of the loan. Instead, the fees for these services are financed through a higher interest rate on the loan. The yield spread premium thus can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership.

HUD has recognized the utility of yield spread premiums in regulations issued prior to the 1999 Statement of Policy. In a final rule concerning "Deregulation of Mortgagor Income Requirements," HUD indicated that up front costs could be lowered by yield spread premiums. 54 FR 38646 (September 20, 1989).

In a 1992 rule concerning RESPA, HUD specifically listed yield spread premiums as an example of fees that must be disclosed. The example was codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 13 in Appendix B to 24 CFR part 3500. (See also Instructions at Appendix A to 24 CFR part 3500 for Completing HUD-1 and HUD-IA Settlement Statements.) HUD did not by these examples mean that yield spread premiums were *per se* legal, but HUD also did not mean that yield spread premiums were *per se* illegal.

HUD also recognizes, however, that in some cases less scrupulous brokers and lenders take advantage of the complexity of the settlement transaction and use yield spread premiums as a way to enhance the profitability of mortgage transactions without offering the borrower lower up front fees. In these cases, yield spread premiums serve to increase the borrower's interest rate and the broker's overall

compensation, without lowering up front cash requirements for the borrower. As set forth in this Statement of Policy, such uses of yield spread premiums may result in total compensation in excess of what is reasonably related to the total value of the origination services provided by the broker, and fail to comply with the second part of HUD's two-part test as enunciated in the 1999 Statement of Policy, and with Section 8.

The 1999 Statement of Policy's Test for Legality

The Department restates its position that yield spread premiums are not per se illegal. HUD also reiterates that this statement "does not imply* * * that yield spread premiums are legal in individual cases or classes of transactions." 64 FR 10084. The legality of any yield spread premium can only be evaluated in the context of the test HUD established and the specific factual circumstances applicable to each transaction in which a yield spread premium is used.

The 1999 Statement of Policy established a two-part test for determining whether lender payments to mortgage brokers are legal under RESPA. In applying Section 8 and HUD's regulations, the 1999 Statement of Policy stated:

> In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (*i.e.*, yield spread premiums or any other class of named payments) to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases and classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets. 64 FR 10084.

Culpepper

The need for further clarification of HUD's position, as set forth in the 1999 Statement of Policy, on the treatment of lender payments to mortgage brokers under Section 8 of RESPA (12 U.S.C. 2607), is evident from the recent decision

of the Court of Appeals for the Eleventh Circuit in *Culpepper*.

In upholding class certification in *Culpepper*, the court only applied the first part of the HUD test, and then further narrowed its examination of whether the lender's yield spread payments were "for services" by focusing exclusively on the presumed intent of the lender in making the payments. The crux of the court's decision is that Section 8 liability for the payment of unlawful referral fees could be established under the first part of the HUD test alone, based on the facts that the lender's payments to mortgage brokers were calculated solely on the difference between the par interest rate and the higher rate at which the mortgage brokers delivered loans, and that the lender had no knowledge of what services, if any, the brokers had performed.

HUD was not a party to the case and disagrees with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy.

Clarification of the HUD Test

It is HUD's position that where compensable services are performed, the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a lender payment to a mortgage broker.

1. *The First Part of the HUD Test*: Under the first part of HUD's test, the total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether

the goods, facilities or services are paid for by the borrower, the lender, or partly by both.

It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed. HUD considers the latter situation to be rare. The common industry practice is that lenders follow underwriting standards that demand a review of originations and that therefore lenders typically know that brokers have performed the services required to meet those standards.

Yield spread premiums are by definition derived from the interest rate. HUD believes that a rate sheet is merely a mechanism for displaying the yield spread premium, and does not indicate whether a particular yield spread premium is a payment for goods and facilities actually furnished or services actually performed under the HUD test. Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved.

Section 8 prohibits the giving and accepting of fees, kickbacks, or things of value for the referral of settlement services and also unearned fees. It is therefore prudent for a lender to take action so as to ensure that brokers are performing compensable services and receiving only compensation that, in total, is reasonable for those services provided. As stated, however, in the 1999 Statement of Policy:

> The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities

> actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are performed or provided for the lender, for the borrower, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible.* * * 64 FR 10086.

The 1999 Statement of Policy provided a list of compensable loan origination services originally developed by HUD in a response to an inquiry from the Independent Bankers Association of America (IBAA), which HUD considers relevant in evaluating mortgage broker services. In analyzing each transaction to determine if services are performed HUD believes the 1999 Statement of Policy should be used as a guide. As stated there, the IBAA list is not exhaustive, and while technology is changing the process of performing settlement services, HUD believes that the list is still a generally accurate description of settlement services. Compensation for these services may be paid either by the borrower or by the lender, or partly by both. Compensable services for the first part of the test do not include referrals or no, nominal, or duplicative work.

2. *Reasonableness of Broker Fees*: The second part of HUD's test requires that total compensation to the mortgage broker be reasonably related to the total set of goods or facilities actually furnished or services performed.

The 1999 Statement of Policy said in part:

> The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or

> facilities actually furnished or services actually performed. 64 FR 10084.

Accordingly, the Department believes that the second part of the test is applied by determining whether a mortgage broker's total compensation is reasonable. Total compensation includes fees paid by a borrower and any yield spread premium paid by a lender, not simply the yield spread premium alone. Yield spread premiums serve to allow the borrower a lower up front cash payment in return for a higher interest rate, while allowing the broker to recoup the total costs of originating the loan. Total compensation to the broker must be reasonably related to the total value of goods or facilities provided or services performed by the broker. Simply delivering a loan with a higher interest rate is not a compensable service. The Department affirms the 1999 Statement of Policy's position on this matter for purposes of RESPA enforcement.

The 1999 Statement also said:

> In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with the amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. 64 FR 10086.

The 1999 Statement of Policy also stated:

> The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders. 64 FR 10081.

In evaluating mortgage broker fees for enforcement purposes, HUD will consider these factors as relevant in assessing the reasonableness of mortgage broker compensation, as well as comparing total compensation for loans of similar size and similar characteristics within similar geographic markets.

Also, while the Department continues to believe that comparison to prices in similar markets is generally a key factor in determining whether a mortgage broker's total compensation is reasonable, it is also true that in less competitive markets comparisons to the prices charged by other similarly situated providers may not, standing alone, provide a useful measure. As a general principle, HUD believes that in evaluating the reasonableness of broker compensation in less competitive markets, consideration of price structures from a wider range of providers may be warranted to reach a meaningful conclusion.

Part B. Providing Meaningful Information to Borrowers

In addition to addressing the legality of yield spread premiums in the 1999 Statement of Policy, HUD emphasized the importance of disclosing broker fees, including yield spread premiums.

> There is no requirement under existing law that consumers be fully informed of the broker's services

> and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. 64 FR 10087.

HUD continues to believe that disclosure is extremely important, and that many of the concerns expressed by borrowers over yield spread premiums can be addressed by disclosing yield spread premiums, borrower compensation to the broker, and the terms of the mortgage loan, so that the borrower may evaluate and choose among alternative loan options.

In the 1999 Statement of Policy, HUD stated:

> * * * HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.
>
> The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, preapplication disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. 64 FR 10087.

HUD currently requires the disclosure of yield spread premiums on the Good Faith Estimate and the HUD-1. The 1999 Statement of Policy said:

> The Department has always indicated that any fees charged in settlement transactions should be

> clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like 'YSP to DBG, POC', for instance, have been noted. [Footnote omitted.] Also the Department has seen examples on the GFE and/or the settlement statement where the identity and/or purposes of the fees are not clearly disclosed.
>
> The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. 64 FR 10086-10087.

While the disclosure on the GFE and HUD-1 is required, the Department is aware and has stated that the current GFE/HUD-1 disclosure framework is often insufficient to adequately inform consumers about yield spread premiums and other lender paid fees to brokers. Under the current rules, the GFE need not be provided until after the consumer has applied for a mortgage and may have paid a significant fee, and the HUD-1 is only given at closing. Because of this, HUD has in recent years sought to foster a more consumer beneficial approach to disclosure regarding yield spread premiums through successive rulemaking efforts. This history is discussed more fully in the 1999 Statement of Policy.[2]

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[2] In both the HUD/Federal Reserve Board Report on RESPA/TILA Reform, 1998, and the HUD/Treasury Report on Curbing Predatory Home Mortgage Lending, 2000, the agencies recommended earlier disclosures to facilitate shopping and lower settlement costs.

Representatives of the mortgage industry have said that since the 1999 Statement of Policy, many brokers provide borrowers a disclosure describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from the lender. While the 1999 Statement of Policy commended the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting such a disclosure to their respective memberships, the Statement of Policy added:

> Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up the compensation. 64 FR 10087.

In HUD's view, meaningful disclosure includes many types of information: what services a mortgage broker will perform, the amount of the broker's total compensation for performing those services (including any yield spread premium paid by the lender), and whether or not the broker has an agency or fiduciary relationship with the borrower. The disclosure should also make the borrower aware that he or she may pay higher up front costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower up front costs, and should identify the specific trade-off between the amount of the increase in the borrower's monthly payment (and also the increase in the interest rate) and the amount by which up front costs are

reduced. HUD believes that disclosure of this information, and written acknowledgment by the borrower that he or she has received the information, should be provided early in the transaction. Such disclosure facilitates comparison shopping by the borrower, to choose the best combination of up front costs and mortgage terms from his or her individual standpoint. HUD regards full disclosure and written acknowledgment by the borrower, at the earliest possible time, as a best practice.

Yield spread premiums are currently required to be listed in the "800" series of the HUD-1 form, listing "Items Payable in Connection with Loan." This existing practice, however, does not disclose the purpose of the yield spread premium, which is to lower up front cost to borrowers. To achieve this end it has been suggested to the Department that the yield spread premium should be reported as a credit to the borrower in the "200" series, among the "Amounts Paid by or in Behalf of Borrowers." The homebuyer or homeowner could then see that the yield spread premium is reducing closing costs, and also see the extent of the reduction.

HUD believes that improved early disclosure regarding mortgage broker compensation and the entry of yield spread premiums as credits to borrowers on the GFE and the HUD-1 settlement statement are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers' best interests.

While the 1999 Policy Statement and IV. Part A. of this Statement only cover certain lender payments to mortgage brokers, as described above, HUD also believes that similar information on the trade-off between lower up front costs and higher interest rates and monthly payments should be disclosed to borrowers on all mortgage loan originations, not

merely those originated by brokers. HUD is aware that while yield spread premiums are not used in loans originated by lenders, lenders are able to offer loans with low or no up front costs required at closing by charging higher interest rates and recouping the costs by selling the loans into the secondary market for a price representing the difference between the interest rate on the loan and the par, or market, interest rate. Sale of such a loan achieves the same purpose as the yield spread premium does on a loan originated by a broker. The Department strongly believes that all lenders and brokers should provide the level of consumer disclosure that the purposes of RESPA intend and that fair business practices demand. As indicated in the 1999 Statement of Policy, HUD emphasizes that fuller information provided as early as possible in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. In the future, full and early disclosures are factors that the Department would weigh favorably in exercising its enforcement discretion in cases involving mortgage broker fees. Nevertheless, the Department also again makes clear that disclosure alone does not make illegal fees legal under RESPA. The Department will scrutinize all relevant information in making enforcement decisions, including whether transactions evidence practices that may be illegal.

Part C. Section 8(b) Unearned Fees

A. Background

RESPA was enacted in 1974 to provide consumers "greater and more timely information on the nature of the costs of the [real estate] settlement process" and to protect consumers from "unnecessarily high settlement charges caused by certain abusive practices * * *" 12 U.S.C. 2601.

Since RESPA was enacted, HUD has interpreted Section 8(b) as prohibiting any person from giving or accepting any unearned fees, i.e., charges or payments for

real estate settlement services other than for goods or facilities provided or services performed. Payments that are unearned fees for settlement services occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In the first situation, two settlement service providers split or share a fee charged to a consumer and at least part, if not all, of at least one provider's share of the fee is unearned. In the second situation, a settlement service provider charges a fee to a consumer for another provider's services that is higher than the actual price of such services, and keeps the difference without performing any actual, necessary, and distinct services to justify the additional charge. In the third situation, one settlement service provider charges a fee to a consumer where no work is done or the fee exceeds the reasonable value of the services performed by that provider, and for this reason the fee or any portion thereof for which services are not performed is unearned.

HUD regards all of these situations as legally indistinguishable, in that they involve payments for settlement services where all or a portion of the fees are unearned and, thus, are violative of the statute. HUD, therefore, specifically interprets Section 8(b) as not being limited to situations where at least two persons split or share an unearned fee for the provision to be violated.

As already indicated in this Statement of Policy, meaningful disclosure of all charges and fees is essential under RESPA. Such disclosures help protect consumers from paying unearned or duplicate fees. However, as noted above, in the 1999 Statement of Policy the Department reiterated "its long-standing view that disclosure alone does not make illegal fees legal under RESPA." 64 FR 10087.

B. HUD's Guidance and Regulations

HUD guidance and regulations have consistently interpreted Section 8 as prohibiting all unearned fees. In 1976, HUD issued a Settlement Costs Booklet that provided that "[i]t is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 FR 20289 (May 17, 1976). Between 1976 and 1992, HUD indicated in informal opinions that unearned fees occur where there are excessive fees charged, regardless of the number of settlement service providers involved.[3]

In the preamble to HUD's 1992 final rule revising Regulation X (57 FR 49600 (November 2, 1992)), HUD stated: "Section 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992).

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[3] See e.g., Old Informal Opinion (6), August 16, 1976 and Old Informal Opinion (65), April 4, 1980; Barron and Berenson, *Federal Regulation of Real Estate and Mortgage Lending*, (4th Ed.1998). On November 2, 1992 (57 F.R. 49600), when HUD issued revisions to its RESPA regulations, it withdrew all of its informal counsel opinions and staff interpretations issued before that date. The 1992 rule provided, however, that courts and administrative agencies could use HUD's previous opinions to determine the validity of conduct occurring under the previous version of Regulation X. *See* 24 CFR 3500.4(c).

HUD's regulations, published on November 2, 1992, implement Section 8(b). Section 3500.14(C)[4] provides:

> No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

24 CFR 3500.14(g)(2) states in part:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of Section 8 and may serve as a basis for a RESPA

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[4] The heading to 24 CFR §3500.14 is titled "Prohibition against kickbacks and unearned fees." However, the heading of subsection (c) is titled "split of charges," and the preamble to the November 1992 rule states "[s]ection 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992). The rule headings and preamble text are a generalized description of Section 8 that is more developed in the actual regulation text. As discussed in Section D of this Statement of Policy, HUD believes that the actual text of the rules, as amended in 1992, makes clear that Section 8(b)'s prohibitions against unearned fees apply even when only one settlement service provider is involved.

investigation. High prices standing alone are not proof of a RESPA violation.

24 CFR 3500.14(g)(3) provides in part:

> When a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person.

In Appendix B to the HUD RESPA regulations, HUD provides illustrations of the requirements of RESPA. Comment 3 states in part:

> The payment of a commission or portion of the * * * premium * * * or receipt of a portion of the payment * * * where no substantial services are being performed * * * is a violation of Section 8 of RESPA. It makes no difference whether the payment comes from [the settlement service provider] or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here [the real estate broker in the example] is being compensated for a referral of business to [the title company].

In 1996, in the preamble to the final rule on the Withdrawal of Employer/Employee and Computer Loan Origination Systems Exemptions[5] (61 FR 29238 (June 7, 1996)), HUD reiterated its interpretation of Section 8(b) of RESPA as follows:

> HUD believes that Section 8(b) of the statute and the legislative history make clear that no person is allowed to receive 'any portion' of charges for

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[5] This final rule was delayed by legislation, but the Department implemented portions of the final rule that were not affected by the legislative delay on November 15, 1996. 61 FR 58472 (November 15, 1996).

> settlement services, except for services actually performed. The provisions of Section 8(b) could apply in a number of situations: (1) where one settlement service provider receives an unearned fee from another provider; (2) where one settlement service provider charges the consumer for third-party services and retains an unearned fee from the payment received; or (3) where one settlement service provider accepts a portion of a charge (including 100% of the charge) for other than services actually performed. The interpretation urged [by the commenters to the proposed rule published on July 21, 1994], that a single settlement service provider can charge unearned or excessive fees so long as the fees are not shared with another, is an unnecessarily restrictive interpretation of a statute designed to reduce unnecessary costs to consumers. The Secretary, charged by statute with interpreting RESPA, interprets Section 8(b) to mean that two persons are not required for the provision to be violated. 61 FR 29249.

The latest revision to the Settlement Costs Booklet for consumers, issued in 1997, also provides "[i]t is also illegal for anyone to accept a fee or part of a fee for services if that person has not actually performed settlement services for the fee." 62 FR 31998 (June 11, 1997)

Further, HUD has provided information to the public and the mortgage industry in the "Frequently Asked Questions" section of its RESPA website, located at *<http://www.hud.gov/fha/sfh/res/resindus.html>*. Question 25 states:

> Can a lender collect from the borrower an appraisal fee of $200, listing the fee as such on the HUD-1, yet pay an independent appraiser $175 and collect the $25 difference?

The answer reads:

> No, the lender may only collect $175 as the actual charge. It is a violation of Section 8(b) for any person to accept a split of a fee where services are not performed.

In 1999, by letter submitted at the request of the Superior Court of California, Los Angeles County, in the case of *Brown v. Washington Mutual Bank* (Case No. BC192874), HUD provided the following response to a specific question posed by the court on lender "markups" of another settlement service provider's fees:

> A lender that purchases third party vendor services for purposes of closing a federally related mortgage loan may not, under RESPA, mark up the third party vendor fees for purposes of making a profit. HUD has consistently advised that where lenders or others charge consumers marked-up prices for services performed by the third party providers without performing additional services, such charges constitute "splits of fees" or "unearned fees" in violation of Section 8(b) of RESPA.

HUD noted in its letter to the court that the response reflected the Department's longstanding position.

C. Recent Cases

Notwithstanding HUD's regulations and other guidance, the Court of Appeals for the Seventh Circuit held, in *Echevarria v. Chicago Title and Trust Co.*, 256 F.3d 623 (7th Cir. 2001), that Section 8(b) was not violated where a title company, without performing any additional services, charged the plaintiffs more money than was required by the recorder's office to record a deed and the title company then retained the difference. The court reasoned that plaintiffs "failed to plead facts tending to show that Chicago Title illegally shared fees with the Cook County Recorder. The

Cook County Recorder received no more than its regular recording fees and it did not give to or arrange for Chicago Title to receive an unearned portion of these fees. The County Recorder has not engaged in the third party involvement necessary to state a claim under [RESPA § 8(b)]." Id. at 626. The court in essence concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b).

Earlier, in *Willis v. Quality Mortgage USA, Inc.*, 5 F. Supp. 2d 1306 (M.D. Ala. 1998), cited by the Seventh Circuit in support of its conclusion, the district court concluded that 24 CFR 3500.14(c), "[w]hen read as a whole," prohibits payments for which no services are performed "only if those payments are split with another party." Id. at 1309. The *Willis* court held that there must be a split of a charge between a settlement service provider and a third party to establish a violation Section 8(b). The court also concluded that 24 CFR 3500.14(g)(3) only applied when there was a payment from a lender to a broker, or vice versa. The payment from a borrower to a mortgage lender could not be the basis for a violation of 24 CFR 3500.14(g)(3) and Section 8(b).

HUD was not a party to the cases and disagrees with these judicial interpretations of Section 8(b) which it regards as inconsistent with HUD's regulations and HUD's longstanding interpretations of Section 8(b).

D. Unearned Fees Under Section 8(b)

This Statement of Policy reaffirms HUD's existing, long-standing interpretation of Section 8(b) of RESPA. Sections 8(a) and (b) of RESPA contain distinct prohibitions. Section 8(a) prohibits the giving or acceptance of any payment pursuant to an agreement or understanding for the referral of settlement service business involving a federally related mortgage loan; it is intended to eliminate kickbacks or compensated referral arrangements among settlement

service providers. Section 8(b) prohibits the giving or accepting of any portion, split, or percentage of any charge other than for goods or facilities provided or services performed; it is intended to eliminate unearned fees. Such fees are contrary to the Congressional finding when enacting RESPA that consumers need protection from unnecessarily high settlement charges. 12 USC 2601 (a).

It is HUD's position that Section 8(b) proscribes the acceptance of any portion or part of a charge other than for services actually performed. Inasmuch as Section 8(b)'s proscription against "any portion, split, or percentage" of an unearned charge for settlement services is written in the disjunctive, the prohibition is not limited to a split. In HUD's view, Section 8(b) forbids the paying or accepting of any portion or percentage of a settlement service—including up to 100%—that is unearned, whether the entire charge is divided or split among more than one person or entity or is retained by a single person. Simply put, given that Section 8(b) proscribes unearned portions or percentages as well as splits, HUD does not regard the provision as restricting only fee splitting among settlement service providers. Further, since Section 8(b) on its face prohibits the giving or accepting of an unearned fee by any person, and 24 CFR 3500.14(c) speaks of a charge by "a person," it is also incorrect to conclude that the Section 8(b) proscription covers only payments or charges among settlement service providers.[6]

A settlement service provider may not levy an additional charge upon a borrower for another settlement service provider's services without providing additional services that are bona fide and justify the increased charge. Accordingly, a settlement service provider may not mark-up the cost of another provider's services without providing

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[6] HUD is, of course, unlikely to direct any enforcement actions against consumers for the payment of unearned fees, because a consumer's intent is to make payment for services, not an unearned fee

additional settlement services; such payment must be for services that are actual, necessary and distinct services provided to justify the charge. 24 CFR 3500.14(g)(3).[7] The HUD regulation implementing Section 8(b) states: "[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section." 24 CFR 3500.14 (c).

The regulations also make clear that a charge by a single service provider where little or no services are performed is an unearned fee that is prohibited by the statute. 24 CFR 3000.14(c). A single service provider is also prohibited from charging a duplicative fee. Further, a single service provider cannot serve in two capacities, e.g., a title agent and closing attorney, and be paid twice for the same service. The fee the service provider would be receiving in this case is duplicative under 24 CFR 3000.14(c) and not necessary and distinct under 24 CFR 3000.14(g)(3). Clearly, in all of these instances, the source of the payment—whether from consumers, other settlement service providers, or other third parties—is not relevant in determining whether the fee is earned or unearned because ultimately, all settlement payments come directly or indirectly from the consumer. See 24 CFR 3500.14(c). Therefore, a single settlement service provider violates Section 8(b) whenever it receives an unearned fee.

A single service provider also may be liable under Section 8(b) when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided. HUD's regulations as noted state: "If the payment of a thing of value bears no relationship to the goods or services provided, then the excess is not for services or goods actually

---

[7] HUD notes that some lenders have charged an additional fee merely for "reviewing" another settlement service provider's services. HUD does not regard such "review" as constituting an actual, necessary, or distinct additional service permissible under HUD's regulations.

performed or provided." 24 CFR 3500.14(g)(2). Section 8(c)(2) only allows "the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or services actually performed," i.e., permitting only that compensation which is reasonably related to the goods or facilities provided or services performed. Compensation that is unreasonable is unearned under Section 8(b) and is not bona fide under Section 8(c)(2).

The Secretary, therefore, interprets Section 8(b) of RESPA to prohibit all unearned fees, including, but not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

IV. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) has reviewed this Statement of Policy in accordance with Executive Order 12866, (captioned "Regulatory Planning and Review"). OMB determined that this Statement of Policy is a "significant regulatory action" as defined in Section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes to the Statement of Policy resulting from this review are available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk.

Dated: October 15, 2001

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 01-26321 Filed 10-15-01; 4:51 pm]
BILLING CODE 4210-27-P

APPENDIX M

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT.

No. 99-14066

Daniel Heimmermann, individually and on behalf of themselves and class described, Emily Heimmermann, individually and on behalf of themselves and a class described, Plaintiffs-Appellees,

v.

First Union Mortgage Corporation, Defendant-Appellant.

Appeal from the United States District Court for the Northern District of Alabama

---

[Filed: November 7, 2001.]

ORDER

The parties are requested to file supplemental briefs addressing the Department of Housing and Urban Development's RESPA Statement of Policy 2001-1 of October 18, 2001. Appellant First Union Mortgage Corporation's brief shall not exceed 15 double-spaced pages and shall be filed no later than 21 November 2001. Appellee Daniel Heimmermann's reply brief shall not exceed 15

double-spaced pages and shall be filed no later than 14 days after receipt of Appellant's brief.

Please contact Matt Davidson at 404-335-6224 to confirm receipt of these directions no later than 4 o'clock p.m. on Wednesday, 7 November 2001.

/s/ James L. Edmondson
UNITED STATES CIRCUIT JUDGE

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT.

No. 99-12110

Scott R. McBride, Jr., on behalf of himself and all others similarly situated, Plaintiff-Appellant,

v.

Reliastar Mortgage Corporation, Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Georgia

---

[Filed: November 7, 2001.]

ORDER

The parties are requested to file supplemental briefs addressing the Department of Housing and Urban Development's RESPA Statement of Policy 2001-1 of October 18, 2001. Appellee Reliastar Mortgage Corporation's brief shall not exceed 15 double-spaced pages and shall be filed no later than 21 November 2001. Appellant Scott McBride's reply brief shall not exceed 15 double-spaced pages and shall be filed no later than 14 days after receipt of Appellee's brief.

Please contact Matt Davidson at 404-335-6224 to confirm receipt of these directions no later than 4 o'clock p.m. on Wednesday, 7 November 2001.

/s/ James L. Edmondson
UNITED STATES CIRCUIT JUDGE

UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT.

No. 99-11554-TT/0011837-TT

Beth A. Richardson, Plaintiff-Appellant,

v.

BankAmerica Corporation, a Delaware corporation, Bank of America FSB, Inc., a Hawaii corporation, Incorporated under the Laws of the United States of America, d.b.a. BankAmerica Mortgage, Defendants-Appellees.

Pamela C. Hirsch, individually, and on behalf of all others simularly situated, David L. Hirsch, Plaintiffs-Appellants,

v.

BankAmerica Corporation, a Delaware corporation, Bank of America FSB, Inc., a Hawaii corporation, BankAmerica Mortgage, a division of BankAmerica FSB, a Hawaii corporation, Defendants-Appellees

---

Appeal from the United States District Court for the Northern District of Georgia

---

[Filed: November 7, 2001.]

ORDER

Motion of Appellants in appeal nos. 99-11554 and 00-11837 to file supplemental briefs addressing the Department of Housing and Urban D evelopment's RESPA Statement of Policy 2001-1 of October 18, 2001 is GRANTED. Appellants' brief shall not exceed 16 double-spaced pages and shall be filed no later than 21 November 2001. Appellees' reply brief shall not exceed 16 double-spaced pages and shall be filed no later than 14 days after receipt of Appellants' brief.

Please contact Matt Davidson at 404-335-6224 to confirm receipt of these directions no later than 4 o'clock p.m. on Wednesday, 7 November 2001.

/s/ James L. Edmondson
UNITED STATES CIRCUIT JUDGE

Supreme Court, U.S.
FILED
DEC 19 2001
CLERK

(2)

No. 01-695

In The

Supreme Court of the United States

IRWIN MORTGAGE CORPORATION,

Petitioner,

v.

JOHN ROBERT CULPEPPER, PATRICIA STARNES CULPEPPER, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, AND BEATRICE N. HIERS, INDIVIDUALLY AND AS A REPRESENTATIVE OF A CLASS OF SIMILARLY SITUATED INDIVIDUALS,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

BRIEF IN OPPOSITION

KIERON F. QUINN
RICHARD S. GORDON
QUINN, GORDON & WOLF, LLP
40 West Chesapeake Avenue, Suite 408
Towson, Maryland 21204
Telephone: 410-825-2300

DAVID R. DONALDSON*
DAVID J. GUIN
TAMMY MCCLENDON STOKES
DONALDSON & GUIN, LLC
2 North 20th Street, Suite 1100
Birmingham, Alabama 35203
Telephone: 205-226-2282

*Counsel of Record

Counsel for Respondents

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

121 pp

CORPORATE DISCLOSURE STATEMENT

Irwin Mortgage Corporation is an Indiana corporation and a wholly-owned subsidiary of IFC Mortgage Corporation. IFC Mortgage Corporation is a wholly-owned subsidiary of Irwin Financial Corporation, a public corporation.

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COUNTER STATEMENT OF THE CASE

It is the standard practice of Irwin Mortgage Corporation, the Petitioner, to pay "yield spread premium fees" (YSPs) directly to mortgage brokers as an inducement for such brokers to refer "above-par" (*i.e.*, high interest rate) mortgage loans to Irwin for funding and servicing. The higher the interest rate obtained by a mortgage broker, the higher the YSP Irwin proposes in its daily rate sheets to pay the broker for the referral of the loan. Irwin's YSPs are calculated as a percentage of the loan amount without regard to the amount or type of work the broker may perform for the borrower and without regard to whether the mortgage broker is owed any additional compensation for his loan origination services. The Plaintiffs/Respondents contend that Irwin's payment of YSPs for the referral of above-par mortgage loans constitutes the payment of "referral fees" prohibited by § 8(a) of the Real Estate Settlement Procedures Act (RESPA), 12 U.S.C. § 2607(a). The Eleventh Circuit has agreed with the Plaintiffs in two interlocutory appeals, and its decisions are not in conflict with any other court of appeals.

BACKGROUND

In 1974, Congress enacted RESPA to eliminate "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services" in the real estate settlement process. 12 U.S.C. § 2601(b)(2), Res. App. 48a. Consistent with this purpose, Congress enacted § 8(a) of RESPA, which provides that:

> (a) **Business referrals**
>
> No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.

12 U.S.C. § 2607(a). Persons who violate this statutory prohibition on referral fees can face up to one year in prison, a fine of $10,000 and civil liability for three times the amount of the referral fee. § 8(d), 12 U.S.C. § 2607(d), Res. App. 49a.

Section 8(c) provides a narrow list of payments that are excluded from § 8(a) and (b) liability. Specifically, § 8(c)(2) exempts any "payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed." 12 U.S.C. § 2607(c)(2). Congress also granted HUD the limited authority to issue formal "regulations" which exempt "other payments or classes of payments" from § 8(a) liability "after consultation with the Attorney General, the Administrator of Veterans' Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture." § 8(c)(5), 12 U.S.C. § 2607(c)(5), Pet. App. 69a.[1] HUD has never availed itself of the authority granted in § 8(c)(5) to

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[1] Congress also provided a general grant of authority to HUD to make certain interpretations, rules and regulations "as may be necessary to achieve the purposes of this chapter." 12 U.S.C. § 2617(a). Congress did not, as Irwin states, grant HUD *carte blanche* authority to "implement RESPA." Pet. at 4.

craft new exemptions from liability, nor has it otherwise issued notice-and-comment regulations regarding § 8(c)(5).

PROCEDURAL HISTORY

The Plaintiffs filed this case on April 11, 1996, alleging that Irwin's YSPs constitute unlawful referral fees in violation of § 8(a), 12 U.S.C. § 2607(a). On November 26, 1996, Irwin filed a motion for summary judgment, arguing that its YSPs were payments for goods (that is, the loan package) and thus, were exempt from § 8(a) liability by reason of § 8(c)(2). Pet. App. 51a. Irwin also argued that since its YSPs were purportedly "reasonable" in amount, they were not illegal. *Id.* at 59a. The district court granted Irwin's motion, and the Plaintiffs appealed to the Eleventh Circuit. *Id.* at 60a.

Culpepper I

On appeal, the Eleventh Circuit "tracked" the language of § 8(a) and set forth the applicable test for § 8(a) liability, holding that "RESPA is violated if (1) a payment of a thing of value is (2) made pursuant to an agreement to refer settlement business and (3) a referral actually occurs." *Id.* at 42a. Applying this statutory test to Irwin's practices, the court concluded that the "undisputed facts compel the conclusion that Inland's payment of the yield spread premium to [the Plaintiffs' mortgage broker] was a referral fee [not payment for goods or services], and thus a violation of RESPA . . . ," and reversed the court's

entry of summary judgment. *Id.* at 42a, 46a.[2] The court also rejected Irwin's claim that the legality of its YSPs turned on the "reasonableness" of the broker's compensation as a whole. *Id.* at 45a ("The market value test is useful only if the payment is for a good or service in the first instance and a determination must be made whether the payment is so excessive that the excess should be characterized as a referral fee.").

Culpepper II

Irwin petitioned the Eleventh Circuit for a rehearing and rehearing *en banc*, arguing that the circuit court had, in effect, inappropriately granted summary judgment in the Plaintiffs' favor, even though the Plaintiffs had not yet moved for summary judgment in the district court. Pet. App. 49a. The Eleventh Circuit denied Irwin's petition, but clarified that Irwin could try on remand to prove that its YSPs were not referral fees. *Id.*[3]

HUD's 1999 policy statement

Following *Culpepper I*, the mortgage industry put intense political pressure on Congress to impose a moratorium on RESPA class actions. Congress refused. *See*

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[2] *See also id.* at 46a ("Under the particular facts here, the yield spread premium Inland paid to Premiere was a prohibited referral fee under RESPA.") ("The yield spread premium payment thus violated RESPA.").

[3] The court noted, "[n]onetheless, . . . that certain facts about the nature of this financial transaction seem to be undisputed which, at a minimum, presents a hurdle for Inland at trial." *Id.*

Real Estate Settlement Procedures Act Class Action Relief Act of 1997, H.R. 1283, 105th Cong. § 2; Mortgage Litigation Reform Act of 1998, S. 2223, 105th Cong. § 2, Res. App. 42a-47a. However, a House of Representatives conference report on the 1999 Appropriations Bill directed HUD to issue a policy statement setting forth its position on the legality of YSPs. *Id.* at 74a. In compliance with the dictates of the report, on March 1, 1999, HUD issued its 1999 policy statement within the required 90 days after consulting with consumer organizations, the mortgage industry, and various government organizations. *Id.* at 76a, 91a. Consistent with *Culpepper I*, the 1999 policy statement set forth a two-part test for determining the legality of YSPs: (1) "whether goods or facilities were actually furnished or services were actually performed *for the compensation paid*"; and (2) "whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." *Id.* at 93a (emphasis added).

The first prong of HUD's 1999 policy statement test tracks the language of § 8(c)(2), which exempts from liability compensation and similar payments made "***for*** goods or facilities actually furnished" or "***for*** services actually performed." 12 U.S.C. § 2607(c)(2) (emphasis added). The second prong adds that even where a payment is actually paid for a bona fide good or service, such as for a credit report or appraisal, it may nevertheless be scrutinized to insure that the payment was not inflated for the purpose of inducing a referral.[4] HUD's General

[4] The second prong of the 1999 policy statement test is consistent with HUD's regulation X which provides that HUD

Counsel further explained the 1999 policy statement analysis as follows:

> HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed **"for" – i.e., in exchange for** – the compensation paid to the broker. . . . The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed. Reg. 10085-86. Accordingly, **the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services.**

See HUD's General Counsel Opinion Letters to Senator Shelby and Congressman Vento, Res. App. 51a-58a (emphasis added).

Culpepper III

On February 25, 1999, the Plaintiffs moved the court to certify a class of borrowers pursuant to Fed. R. Civ. P. 23(b)(3). *Id.* at 11a. Irwin argued (as it does here – Pet. at 6) that the 1999 policy statement required only proof that

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"may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 C.F.R. § 3500.14(g)(2) (emphasis added).

any service had been performed and that the court then would be required to determine the reasonableness of the broker's total compensation in each mortgage transaction to be able to determine § 8(a) liability without regard to whether the payments were made in exchange for the broker's services. *Id.* at 23a. Irwin contended that its "reasonableness of total compensation" test for liability created overwhelming individual issues, thereby preventing class certification. *Id.* Plaintiffs countered that Irwin's "reasonableness of total compensation" test finds no support in the statute or legislative history. Plaintiffs argued that to pass muster under the first prong of the 1999 policy statement test and to be consistent with the clear terms of § 8 and the Eleventh Circuit's earlier decision in *Culpepper I*, the YSP must be paid "in exchange for" the broker's services. The district court agreed and certified the Plaintiffs' class. *Id.* at 24a, 27a.[5] The district court issued a subsequent opinion on July 20, 1999, clarifying that HUD's 1999 policy statement did not undercut, and in fact supported, its determination that certification of the case was proper. *Id.* at 30a, 32a-35a.

Irwin petitioned the Eleventh Circuit to permit an interlocutory appeal of the district court's class certification order pursuant to Rule 23(f), which the Eleventh Circuit granted on September 29, 1999. *Id.* at 3a. The

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[5] The district court did not base its class certification decision, as Irwin suggests, solely on the basis of how YSPs are calculated. On the contrary, the court's central focus was on the fact that Irwin had been incapable of showing that its "yield spread premium is tied in some fashion to the services provided it by the broker." Pet. App. 26a.

circuit court found that in order to determine the propriety of class certification, the "crux of the appeal" would be to determine the applicable standard of liability under § 8(a). The circuit court focused its attention on the plain language of the statute and found that HUD's 1999 policy statement's two-part test was consistent with the statute and the court's earlier statutory analysis set forth in *Culpepper I*. *Id.* at 10a. The circuit court rejected Irwin's proposed "reasonableness of total compensation" test, however, as inconsistent with the statute. *Id.* at 10a ("Irwin's reading of the Statement is not only inconsistent with the Statement itself; it also would make the Statement clash with § 8(c)'s language.") ("The statute itself thus implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor. . . . "); *see also id.* at 11a ("we should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws.").

The circuit court then determined that the Plaintiffs' proof that Irwin's general practice of paying YSPs is illegal under § 8(a)–that is, "the terms and conditions under which a lender pays the broker a yield spread premium"–is subject to class-wide evidence. *Id.* at 14a. On June 15, 2001, the Eleventh Circuit affirmed certification of the class. *Id.*[6] Irwin petitioned the Eleventh Circuit

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[6] Irwin claims that its YSPs are beneficial to homeowners, allowing them to finance closing costs, and that *Culpepper III* renders all YSPs illegal (Pet. at 2, 13). On the contrary, the Eleventh Circuit in both *Culpepper II* and *III* explained that it was not holding YSPs illegal per se. Rather, the circuit court simply required evidence that YSPs are used to reduce closing costs to borrowers for services that were actually performed,

for rehearing and rehearing *en banc*, which the circuit court denied on August 15, 2001. *Id.* at 67a.

HUD's 2001 policy statement

Since Congress had earlier refused to do their bidding,[7] the mortgage industry lobbyists prevailed upon the new HUD administration to issue a new policy statement. The Mortgage Bankers Association drafted a proposed "clarification" of the 1999 policy statement, which was incorporated by HUD into its 2001 policy statement. Res. App. 1a-41a.

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which Irwin claims is the purpose of its YSPs. Pet. App. 12a, 48a-49a. The problem, as recognized by the circuit court, is that Irwin has not produced any evidence that its YSPs are used to finance borrowers' closing costs. Indeed, Irwin has not produced one class members' HUD-1 Settlement Statement showing that the borrower received a credit on line 200 under the section "paid on behalf of the borrower" against his closing costs in exchange for Irwin's payment of a YSP. Irwin's argument that YSPs are used to reduce closing costs while inventive, is completely unsupported by the record.

[7] *See* Lenders Ask HUD to Clarify Legality of Yield Spread Premiums, Collections World (July 12, 2001), Res. App. 59a-61a. In this article, the Mortgage Bankers Association admitted that "[g]etting Congress to act would not be easy." In fact, "[s]everal industry officials noted that getting legislative relief would be nearly impossible and it would take too long to be effective." The article further notes that "HUD has been very responsive," and that the industry is "confident, based on the new administration and the people appointed, that they are going to be responsive to this problem."

On October 18, 2001, HUD issued its 2001 policy statement, purporting to "clarify" the 1999 policy statement and setting forth the new administration's disagreements with the Eleventh Circuit's prior *Culpepper III* decision. *Id.* at 107a. The 2001 policy statement adopts the same "reasonableness of total compensation" test that the Eleventh Circuit has twice rejected as irrational and inconsistent with the plain language of the statute. *Id.* at 119a-121a.[8]

The case is currently on remand to the district court. After issuance of the 2001 policy statement, the district court requested briefs from the parties regarding what, if any, deference it should give the 2001 policy statement and inquiring whether it is bound by the "law of the case" doctrine. Pet. App. 63a. The parties have fully briefed these issues and are awaiting a decision by the trial court.

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[8] Irwin's suggestion that the 2001 policy statement was issued pursuant to a congressional delegation of authority (Pet. at 12) to HUD is unsupported. The 1999 policy statement, of which the 2001 policy statement purports to be a "clarification," was issued at the directive of a House conference report and accordingly lacks the force of law. *See, e.g., EEOC v. Metropolitan Educational Enterprises, Inc.*, 60 F.3d 1225, 1228-29 (7th Cir. 1995), *rev'd on other grounds*, 519 U.S. 202 (1997); *In re North*, 50 F.3d 42, 46 (D.C. Cir. 1995). Moreover, the 2001 policy statement does not comply with the dictates of that report, which required HUD to issue its policy statement within 90 days and to seek comment from federal agencies, consumer and industry groups and other interested parties before issuing the statement. H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. at 260 (1999).

STATEMENT OF FACTS[9]

Irwin is one of several mortgage lenders competing for the business of originating, financing, selling and servicing residential mortgages. Vol. I, Doc. 49 at 7.[10] Irwin originates mortgages both through branch offices staffed by its employees (its "retail" division) and

---

[9] Irwin's petition contains several misrepresentations of the record. An accurate statement of the undisputed facts and evidence on record is given in the Eleventh Circuit's *Culpepper I* and *III* opinions. *See* Pet. App. at 2a-4a, 38a. The circuit court recapped those facts in *Culpepper III*, explaining:

> The "yield spread premiums" at issue in this case, as the panel explained more fully in *Culpepper I*, are payments from Irwin to its mortgage brokers that the written agreement between them contemplates, but does not define. Each business day, Irwin distributes a rate sheet to its brokers, listing the terms of the loans Irwin is offering that day. The loans' interest rates are set with reference to a "par rate." If the broker originates a loan at a below-par rate, it gets no compensation from Irwin. On the other hand, originating a loan at an above-par rate garners the broker a yield spread premium, whose amount is determined by a formula that includes the amount of the loan and the difference between the loan rate and the par rate. The formula does not take into account the amount of work the broker actually performed in originating the loan or how much the borrower paid in fees for the broker's services. . . . Those facts satisfy § 8(a), the panel concluded. That § 8(a) conclusion remains unchallenged on this appeal.

Id. at 4a.

[10] All record cites are to the district court for the Northern District of Alabama.

through its use of mortgage brokers (its "wholesale" division). Vol. I, Doc. 49 at 6-7. Mortgage brokers are independent businesses which originate mortgages on behalf of various lenders. Vol. I, Doc. 49 at 15; Vol. I, Doc. 52 at 13.[11] While the loan officers in its "retail" operation originate mortgages exclusively for Irwin, Irwin must compete with other lenders to obtain referrals of business from its broker network, since each broker typically originates mortgages for numerous lenders. Vol. I, Doc. 50 at 21-22.

Each business day, Irwin and other lenders fax to this network a rate sheet reflecting a variety of interest rates for each type of loan that they will make to qualified borrowers. Pet. App. at 3a, 38a. A given interest rate for a particular loan is said to be either a "par," an "above par," or a "below par" rate. *Id.* at 38a. By definition, the par rate "is the lowest interest rate at which Irwin will make loans without charging the borrower 'discount points.' " *Id.* at 38a. If a mortgage broker refers Irwin a loan at a below par rate, Irwin requires the borrower to pay "discount points" for the loan. *Id.* If the broker refers Irwin a loan with interest at an above par rate, Irwin pays a YSP directly to the broker. *Id.* at 3a, 38a.

Irwin's method of determining its YSPs is "not tied to services, but to the size and interest rate" of the Plaintiffs' and Class Members' loans. Pet. App. at 3a, 39a. Irwin's rate sheets demonstrate how the amount of the YSP is

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[11] Plaintiffs object to Irwin's insinuation that mortgage brokers provide facilities and goods in exchange for the payment of YSPs (Pet. at 3). There is no evidence in the record that ties Irwin's payments of YSPs to anything but the referral of valuable business.

"solely a function of the extent to which the interest rate on the loan exceed[s] Inland's par rate." *Id.* at 39a. Irwin calculates YSPs based on the prices it expects to receive for the mortgage when it sells the loan on the secondary market and on economic factors, such as market volatility and competition with other lenders for referrals. Vol. I, Doc. 51 at 17, 21 and Doc. 50 at 42. Irwin's decision whether to pay a YSP is totally divorced from the question whether the broker is owed any additional compensation for its services. Irwin pays YSPs without regard to the amount of work performed by the broker in originating the mortgage and regardless of the amount of loan origination fee charged by the broker. Pet. App. at 3a-4a, 44a. Irwin uses YSPs as nothing more than incentives to brokers to steer mortgage loans to Irwin. Vol. I, Doc. 50 at 42 and Doc. 52 at 13. These rate sheets are not considered public information and are not shown to the borrowers. Irwin's brokers, not the borrowers, select the interest rates for each loan, contrary to Irwin's contention at page 4 of its petition. Vol. I, Doc. 52 at 14, 75-76.[12]

On October 30, 1995, John and Patricia Culpepper met with Nancy Blankensopp at Premiere Mortgage Company ("Premiere") to discuss financing for the Culpeppers' purchase of a new home. Vol. 4, Doc. 62 at 29. From Irwin's rate sheet, Ms. Blankensopp selected an interest rate of 7.5% on a thirty-year loan of $77,761.00 for the

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[12] Irwin's contention that borrowers are always aware of the payment of YSPs (Pet. 8) is unsupported. Upon reviewing thousands of loan files at Irwin's headquarters, the undersigned counsel found that it was not uncommon for the YSP not to be listed on any of the closing documents given to the borrower.

Culpeppers. Pet. App. at 38a. Unbeknownst to the Culpeppers, 7.5% was an above par interest rate for their loan. *Id.* at 38a. In actuality, Irwin would have made the same loan to the Culpeppers at an interest rate of approximately 7.25%. *Id.* When the Culpeppers' loan closed on December 15, 1995, they paid Premiere an origination fee of $760.50 (1% of the loan amount) for Premiere's assistance in obtaining and closing their loan. *Id.* Irwin paid the broker a $1,263.61 YSP (1⅝%) for referring it an above par interest rate loan.[13] *Id.*

Ms. Hiers, the other class representative, also originated an FHA mortgage from Irwin with the assistance of a broker, Homebuyers Mortgage Company ("Homebuyers"). Vol. I, Doc. 50 at 19. Homebuyers secured for her a 7% Adjustable Rate Mortgage (ARM) on her $159,750 mortgage. *Id.* at 35-56. Unbeknownst to Ms. Hiers, the 7% ARM was an above par interest rate loan for which Homebuyers received a substantial YSP, in addition to the other payments made in connection with the origination of the loan. Vol. I, Doc. 48 at J. Homebuyers was paid the FHA maximum 1% origination fee ($1,544.00) plus loan discount points of 3% – $4,736.22. Vol. I, Doc. 48 at G. On top of these fees, Irwin paid Homebuyers a YSP of 2.875% – $4,538.87. *Id.* Irwin's rate sheet shows that Ms. Hiers would have obtained the

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[13] Irwin incorrectly states that Premiere received only a loan origination fee and YSP in connection with the Culpeppers' loan. Pet. at 7. In fact, Premiere received almost $400 more in compensation for its origination services. Vol. I, Doc. 48 at F. Moreover, Irwin itself received over $300 for origination services it performed on the Culpeppers' loan. *Id.*

same loan at about a 5½% interest rate with no YSP to the broker. *Id.* at J.

Irwin falsely states that the Culpeppers and Ms. Hiers financed their closing costs through YSPs (Pet. at 8). That argument ignores the undisputed fact that neither of the Plaintiffs owed any additional compensation to the brokers. The Eleventh Circuit already has expressly determined that "[n]o evidence suggests that this $760.50 payment was not intended by both Premiere and the Culpeppers to compensate Premiere fully for the work it did for the Culpeppers." Pet. App. at 44a. Irwin provides no support for its contention that Homebuyers was not fully compensated by the $6,280.22 origination fee and points it received for originating Ms. Hiers' $159,750 FHA loan.

The Plaintiffs and Class Members all obtained FHA mortgage loans that were referred to Irwin by a mortgage broker in exchange for a YSP.[14]

REASONS FOR DENYING THE PETITION

Irwin has not satisfied any of this Court's requirements for granting a petition to vacate a circuit court's opinion and remand the case for reconsideration (GVR).

[14] Plaintiffs' class is defined to include only those borrowers who originated their loans through the use of a broker.

First, the issues presented by Irwin have been fully considered by the Eleventh Circuit on three prior occasions in this litigation. There is no hint, much less a "reasonable probability," that the Eleventh Circuit–if given a *fourth* opportunity to hear the Petitioner's same arguments–would reverse itself. *See Lawrence v. Chater*, 516 U.S. 163, 167 (1996) (requiring "reasonable probability that the decision below rests upon a premise that the lower court would reject if given the opportunity for further consideration"). The Eleventh Circuit already has found Irwin's interpretation of § 8 of RESPA to be irrational and in conflict with the plain language of the statute. That HUD has now espoused the same rejected argument in an improperly issued policy statement makes it no more rational or consistent with the clear language of the statute.

Moreover, under the procedural posture of this case, respect for the lower courts' continued jurisdiction and authority on remand mandates denial of the GVR Petition. Because the Eleventh Circuit's ruling was interlocutory, no final judgment has been entered and the case has been remanded to the district court for further proceedings. Not only does Irwin have the opportunity to present its arguments to the district court on remand, it already has done so. The same issues raised here by Irwin have been fully briefed for the district court on remand, and the parties are awaiting the district court's decision. Respect for lower courts counsels against issuance of a GVR that would deprive the district court of the opportunity to first address Irwin's arguments. The fact that these issues are pending below eliminates any concern that Irwin will face an adverse judgment, the basis for

which has not been fully considered, absent the grant of GVR.

Furthermore, a resolution of the issue presented by Irwin would not be dispositive. The district court also has before it other issues, such as the applicability of the "law of the case" doctrine, similar principles of *stare decisis*, and the viability of the current and alternative class definitions under the 2001 policy statement, which have not previously been addressed in the lower courts, but which may obviate the issues raised here by Irwin. This Court should deny Irwin's Petition to allow the lower courts to first address these related issues so that in the event the case returns to this posture, this Court will have a full record on all issues potentially bearing on the applicability of the 2001 policy statement to the facts of this case.

Although Petitioner alternatively seeks plenary review, it has admitted that the opinion below does not conflict with a decision of any other circuit court of appeals. Irwin has suggested no other basis for a grant of plenary review, and accordingly has failed to provide this Court any appropriate basis for plenary review.[15]

I. PETITIONER HAS PRESENTED NO COMPELLING NEED FOR THE GRANT OF "GVR."

This Court has cautioned that its GVR power "should be exercised sparingly." *Lawrence v. Chater*, 516 U.S. 163, 173 (1996). GVR is appropriate only when the court below

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[15] Even so, plenary review is not appropriate because the opinion below was correctly decided.

did not fully consider potentially determinative factors that undermine the basis for its holding and when there is also a "reasonable probability" that the circuit court would substantially modify its holding if given the opportunity to reconsider. *Id.* at 167. Even in such cases, a grant of GVR is not automatic, but depends on a balance of the equities. *Id.* at 168. None of these factors supports a grant of GVR in this case.

A. The Eleventh Circuit Will Have an Opportunity to Hear Petitioner's Arguments After the Record Is Developed on Remand to the District Court.

Unlike other cases in which this Court has issued an order of GVR, no final judgment has been entered in this case. Irwin is in no danger of having a judgment against it become final without an opportunity for the courts to fully consider potentially determinative new factors. To the contrary, this case is on remand to the district court, and Irwin has argued the very same issues there that it asserted in its Petition, *i.e.*, that HUD's 2001 policy statement is entitled to deference and negates the Eleventh Circuit's opinions below. The parties have fully briefed these and related issues discussed *infra*. As of the date of this Response, the parties are awaiting the district court's ruling.

Whatever determination the district court makes will at the appropriate time become appealable to the Eleventh Circuit, so there is no credence to Irwin's assertion that absent GVR, the Eleventh Circuit will have been deprived of the opportunity to consider the impact of

HUD's 2001 policy statement on its earlier opinions.[16] Irwin is fully protected against entry of an ill-considered judgment. The equities strongly favor denial of the Petition.

B. Additional Issues Are Awaiting the District Court's Decision on Remand That May Prove Dispositive.

Even if Irwin is correct that HUD's 2001 policy statement would otherwise be entitled to deference, related issues presented to the trial court may prove dispositive. For example, the district court could reject Irwin's arguments based on the "law of the case" doctrine or *stare decisis* in light of the fact that the Eleventh Circuit first rejected Irwin's (and now HUD's) statutory interpretation in 1998, a year before HUD's 1999 policy statement and three years before the 2001 policy statement.[17] The Eleventh Circuit expressly reserved a ruling on the applicability of these doctrines (Pet. App. at 9a) so these issues are being addressed for the first time by the district court.

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[16] Likewise, the Eleventh Circuit has requested briefs on the significance of, and amount of deference due, HUD's 2001 policy statement in three other cases challenging YSPs under § 8 of RESPA. *Heimmerman v. First Union Mortgage Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999), *petition to appeal granted*, No. 99-14066 (11th Cir. Oct. 19, 1996); *McBride v. ReliaStar Mortgage Corp.*, No. 1:98-CV-215-TWT (N.D. Ga. Apr. 29, 1999), *petition to appeal granted*, No. 99-12110 (11th Cir. Oct. 19, 1999); *Hirsch v. BankAmerica Corp.*, No. 1:98-CV-1031-ODE (N.D. Ga. Apr. 20, 1999), *petition to appeal granted*, No. 001183-TT (11th Cir. June 9, 1999).

[17] Moreover, the Plaintiffs' and almost all class members' loans were closed prior to even the 1999 policy statement.

The district court also has under consideration the issue of whether, if due deference, the 2001 policy statement may be applied retroactively to defeat this class. *See NBC v. Satellite Broadcast Networks*, 940 F.2d 1467, 1470 n.4 (11th Cir. 1991); *see also Bowen v. Georgetown Gen. Hosp.*, 488 U.S. 204, 208 (1988) ("[A] statutory grant of legislative rulemaking authority will not . . . be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by Congress in express terms.").

Additionally, in the unlikely event the district court determines that the 2001 policy statement governs this case, the district court will be called upon to consider whether the current (or alternative) class definitions nevertheless pass muster under that analysis. The Eleventh Circuit expressly reserved an opinion on a "fallback" position argued by the Plaintiffs "that FHA regulations applicable to FHA loans make any compensation to the broker over 1% of the loan value per se unreasonable." Pet. App. at 121. If the district court disagrees with this argument, it then will be called upon to address alternative class definitions that include only YSPs that are so egregious as to be unreasonable as a matter of law–such as a class including only mortgage loan transactions in which Irwin paid mortgage brokers a YSP for the referral of an above par (*i.e.*, higher interest rate) loan, even though the borrower paid "discount points" to ***reduce*** the interest rate.

Any of these issues pending before the district court could moot the issues here. The parties should be permitted to further develop their positions and the record on these related issues in the courts below before requiring

the Eleventh Circuit to address Irwin's arguments a fourth time.

C. The Eleventh Circuit Has Fully Considered–and Rejected as Irrational and Inconsistent With the Statute–the "Reasonableness of Total Compensation" Test for § 8 Liability Adopted by the 2001 Policy Statement.

GVR is inappropriate because the Eleventh Circuit has fully considered and rejected the statutory interpretation espoused in HUD's 2001 policy statement. Although the 2001 policy statement was not released until after issuance of the Eleventh Circuit's opinion below, the "reasonableness of total compensation" test for § 8 liability adopted in that policy statement has been advanced by Irwin for years, and has been repeatedly rejected by the Eleventh Circuit as irrational and inconsistent with the clear language of the statute.

Section 8(a) of RESPA plainly and unambiguously prohibits the payment or receipt of referral fees in connection with the closing of a federally related residential mortgage. 12 U.S.C. § 2607(a). Irwin claims an exemption from liability for its YSPs under § 8(c)(2), which exempts payments for goods or services actually provided. 12 U.S.C. § 2607(c)(2).

Irwin's contention that YSPs are used to pay for brokers' services is based on its argument that the ***potential*** exists for mortgage brokers to reduce their charges to borrowers in anticipation of receiving a YSP from lenders such as Irwin. Despite its failure to produce any evidence that the Plaintiffs or any class members did, in fact, enjoy

any reduction in up-front costs resulting from YSP payments, Irwin argues that its YSPs paid to brokers for the referral of loans nevertheless constitute "payments . . . for services actually performed," and are thus entitled to an exemption from liability under § 8(c)(2). According to Irwin, since all brokers perform services for borrowers, a lender's YSP payment to a broker–regardless of the lender's intent in making the payment–can constitute an illegal referral fee *only* to the extent that the total compensation received by the broker exceeds "reasonable" compensation for the broker's services as determined by industry standards (hereafter, the " 'reasonableness of total compensation' test").

The clarity of the statute led the Eleventh Circuit to first reject Irwin's "reasonableness of total compensation" test in this case in 1998. The Eleventh Circuit ruled that Irwin's YSP to the Plaintiffs' broker violated § 8(a) because it was undisputed that they did not owe any additional compensation for their broker's services in excess of their 1% loan origination fee. Pet. App. at 43a-44a. The Eleventh Circuit further rejected Irwin's assertion that referral fees are prohibited by § 8(a) only if total compensation received by the mortgage broker was unreasonable, and instead found such a reasonableness test to have value only in those limited cases in which an otherwise agreed and appropriate payment to a broker (such as for a credit report) "is so excessive that the excess should be characterized as a referral fee." *Id.* at 45a.

The 1999 policy statement implicitly recognized and acquiesced in the Eleventh Circuit's earlier *Culpepper*

opinions[18] and established a two-pronged test for § 8 liability consistent with *Culpepper*:

> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. . . . The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

Id. at 93a. In prior arguments to the courts below, Irwin construed the "first prong"of the test by omitting the "for the compensation paid" language. In Irwin's analysis, the first prong is satisfied in every case because the broker performs some services for every brokered loan. *Id.* at 8a-9a.

Plaintiffs argued that in order to pass muster under the first prong of the 1999 HUD policy statement test and to be consistent with *Culpepper I* and the clear terms of § 8, the YSP must be paid in exchange for the broker's services. The district court agreed and certified the class since no other significant issues were raised by Irwin.

The Eleventh Circuit accepted Irwin's interlocutory appeal of the order pursuant to Fed. R. Civ. P. 23(f). Irwin reiterated its "reasonableness of total compensation" test,

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[18] *See* Pet. App. at 91a (stating that HUD was providing its views on "the legality of fees to mortgage brokers from lenders **under existing law**") (emphasis added).

which the circuit court again rejected as inconsistent with the statute. *Id.* at 9a-12a.

Most importantly, the Eleventh Circuit found no ambiguity in the language of the statute, nor did it merely resolve an ambiguity in the language of the 1999 policy statement. Irwin's contention that the court of appeals "determined that RESPA was ambiguous" (Pet. 21) is unsupported by any citation and simply is not true, thus undercutting its entire argument that HUD, as the agency charged with resolving statutory ambiguities, should be given deference. The Eleventh Circuit's *Culpepper* decisions amply demonstrate that the Eleventh Circuit premised its conclusions on its reading of the plain language of the statute and concluded that Irwin's (and now HUD's) interpretation of the 1999 policy statement conflicted with that explicit language. The following quotes from *Culpepper III* are illustrative:

- "[W]e should avoid reading § 8(c) to bless conduct that § 8(a) plainly outlaws." *Id.*
- "Under § 8(a), a payment whose reason is to compensate for referrals is illegal, period." *Id.* at 11a.
- "If Irwin has read the HUD Statement correctly, however, HUD has now decided that § 8(c) deems *some* such referral fees legal – that is, referral fees that are paid by lenders and that would be reasonable service fees, if that's what they were. The plaintiffs' reading of the HUD Statement, by contrast, keeps § 8(c) as a gloss on § 8(a): Paying referral fees may be prohibited (as § 8(a) provides), but paying service fees is not (as § 8(c) provides), unless of course the lender pays so much that we can legitimately suspect a disguised referral fee. We prefer this reading of the HUD

Statement, which preserves the harmony of § 8(a) and 8(c)." *Id.*

- "The statute itself thus implies very strongly that only payments whose reason is compensation for services fall within § 8(c)'s safe harbor, and we hesitate to read the HUD Statement to stray from the statute by imposing no such limit on legality." *Id.* at 10a.

- "Irwin's reading of the Statement is not only inconsistent with the Statement itself; it also would make the Statement clash with § 8(c)'s language." *Id.*

- "[A]ccepting Irwin's view would have the HUD Statement create an inconsistency between § 8(a)'s liability test and § 8(c)'s exclusion from liability." *Id.*

- "The structure and language of the HUD Statement and of RESPA § 8 thus support the plaintiffs' proposed rule of liability far better than Irwin's." *Id.* at 11a.

The 2001 policy statement does nothing more than rehash the same "reasonableness of total compensation" test that the Eleventh Circuit already has addressed. Given the history of this litigation, it is difficult to conclude that the courts below have not had the opportunity to fully consider the arguments reduplicated here by Irwin. Both the district court and the Eleventh Circuit have extensively considered the "reasonableness of total compensation" test now contained in HUD's 2001 policy statement, and have repeatedly rejected this industry-crafted interpretation as irrational and inconsistent with

the clear statutory language.[19] GVR would serve no purpose in this case.

D. GVR Is Inappropriate Because HUD's 2001 Policy Statement is Not Entitled To Consideration, Much Less Deference.

1. Policy statements do not warrant *Chevron*-style deference.

Under *Christensen v. Harris County*, 529 U.S. 576 (2000), HUD's informal policy statement is not entitled to deference. *Id.* at 587 ("Interpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference."); *see also United States v. Mead*, 533 U.S. 218, 121 S. Ct. 2164, 2175 (2001) (Policy statements "are beyond the *Chevron* pale.").[20]

This Court accordingly has directed lower courts to draw a critical distinction between notice-and-comment rulemaking and policy statements. *See Catskill Mountains*

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[19] Indeed, although Irwin asserts that the 2001 policy statement "clarifies" the interpretation the prior HUD administration supposedly intended to articulate in its 1999 policy statement, the Eleventh Circuit has already addressed *this* contention as well, and concluded that *even if* HUD had intended in its 1999 policy statement to adopt Irwin's interpretation, such an interpretation would be irrational. *See* Pet. App. 11a.

[20] These decisions had not been issued at the time the parties briefed and argued *Culpepper III*. Any mention by the Eleventh Circuit of the deference owed the 1999 policy statement should be read in that light.

Chapter of Trout Unlimited, Inc., et al. v. City of New York, No. 00-9447, 2001 WL 1267391 at *7 (2d Cir. Oct. 23, 2001) (rejecting EPA's position taken in several policy statements regarding the Clean Water Act), Res. App. 77a.

Thus, even if remanded, the Eleventh Circuit may give respect to the 2001 policy statement only to the extent that it has "power to persuade"; that is, it should be accorded no more weight than a brief of one of the parties. *Christensen*, 529 U.S. at 587 (such interpretations "are 'entitled to respect' under our decision in *Skidmore* . . . , but only to the extent that those interpretations have the 'power to persuade.' "); *Mead*, 121 S. Ct. at 2171; *see also Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

The Eleventh Circuit already has determined that Irwin's interpretation is not persuasive. The 2001 policy statement accordingly is not entitled to deference.

2. The 2001 policy statement is not entitled to consideration because it is ultra vires.

RESPA contains two statutory grants of rulemaking authority. Section 19(a), 12 U.S.C. § 2617(a), upon which Irwin's arguments rely, is a general grant of authority that authorizes HUD to "proscribe such rules and regulations, to make such interpretations, and to grant such exemptions, as may be necessary to achieve the purposes of [RESPA]."[21] However, the section of RESPA at issue in

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[21] The 2001 policy statement purports to be an "interpretation of Section 8" issued pursuant to "Section 19(a)" of RESPA. Pet. App. at 109a.

this case, § 8(c), 12 U.S.C. § 2607(c), contains its own, more specific grant of authority:

> Nothing in this section shall be construed as prohibiting . . . (5) such other payments or classes of payments or other transfers as are specified in *regulations* prescribed by the Secretary, after consultation with the Attorney General, the Secretary of Veterans Affairs, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Secretary of Agriculture. (emphasis added)

Since § 8(c)(5) pertains specifically to § 8 liability, it trumps the more general § 19(a) provision relied upon by Irwin. *See Balfour Beatty Bahamas, Ltd. v. Bush*, 170 F.3d 1048, 1050 (11th Cir. 1999) ("It is a general rule of statutory construction that a more specific statute covering a particular subject is controlling over a statutory provision covering the same subject in more general terms."). The 2001 Policy Statement is an attempt to create a class of payments that are exempt from § 8(a) liability without complying with the procedural requirements of § 8(c)(5).

HUD has never promulgated regulations regarding § 8 in compliance with § 8(c)(5) or otherwise. Its 2001 policy statement constitutes an unlawful and ultra vires attempt to sidestep the steps required of it by Congress. *See supra* n.8.

II. PLENARY REVIEW IS UNWARRANTED

Irwin admits that "the opinion below does not conflict with any other court of appeals decision," (Pet. 23) and weakly asserts only that a few district courts–without

even citing them–have reached contrary conclusions with respect to class certification (though not necessarily with respect to the same issues raised by the Petition). The prospect that a split in the circuits "might" at some time in the future develop does not present a compelling reason for granting plenary review of the decision below.

CONCLUSION

The Petition for writ of certiorari should be denied.

Respectfully submitted,

*David R. Donaldson
David J. Guin
Tammy McClendon Stokes
Donaldson & Guin, LLC
2 North 20th Street, Suite 1100
Birmingham, Alabama 35203
(205) 226-2282
(205) 226-2357 (facsimile)

Counsel of Record

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Rules and Regulations
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

Office of the Assistant Secretary for Housing – Federal Housing Commissioner
24 CFR Part 3500
[Docket No. FR-4450-N-01]

RIN 2502-AH33
Real Estate Settlement Procedures Act (RESPA) Amended Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers
Part IV

DATE: ~~**Monday, March 1, 1999**~~ **July ___, 2001**

ACTION: **Amended** Statement of Policy 1999-1.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that

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[*10080]

"Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA)]" (Id.). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (Id.).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (See 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be

presumed legal if the mortgage broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report containing legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who funded the loan. The rise in technology permitted much more effective and faster

exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship with the borrower and, in some states, may be found to owe a [*10081] responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will

translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (e.g., 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or "yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time.

The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points).[1] In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan

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[1] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

rates for borrowers and/or that this compensation system is illegal under RESPA.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves.[2] Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services' " (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions

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[2] In many instances, these loans are called "no cost" or"no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a bona fide transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93-866 (1974) *reprinted in* 1974 [*10082] U.S.C.C.A.N. 6548). Section 2 of the Act provides:

> "significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result –
>
> in more effective advance disclosure to home buyers and sellers of settlement costs; [and]
>
> (2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * * " 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur

in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD-VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93-866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the part of most home buyers about the settlement process and its costs,

which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93-866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices" – kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93-866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section

[8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished" were not intended to be prohibited (Id).[3] It also provided that "[t]hose persons and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (Id.)

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan. (Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102-550, approved October 28, 1992; 104 Stat. 4413). At the same

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[3] One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient services are provided, RESPA is intended to prohibit payment.

time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (Id.)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lender-paid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B [*10083] to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums"

and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of per se legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided*. These facts may be used as evidence of a violation of section 8 and may serve as a basis

> for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in

the transaction, before the consumer applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that did not exceed a test, to be established in the rulemaking, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers'

fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct [*10084] payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the

facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with estimated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy.

Under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105-769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

~~In determining whether a payment from a lender~~ **Under Section 8 of RESPA, 12 U.S.C. § 2607(c), the question is whether a lender payment** to a mortgage broker is **compensation for goods or facilities actually furnished, or services actually provided. In determining whether a payment from a lender to a mortgage broker is for goods, services or facilities and therefore** permissible under Section 8 of RESPA, ~~the~~ **HUD applies a two-part test. The** first question is whether goods or facilities were actually furnished or services were actually performed ~~for the compensation paid~~. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price

structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR Sec. 3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real source of funds (i.e., table-funded transactions or transactions involving "intermediary" brokers). In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where [*10085] mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. ~~Payments~~ Broker Must ~~Be for~~ Provide Compensable Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed ~~for the total compensation paid to the mortgage broker~~. In making the determination of whether compensable services are performed, HUD's letter to the

Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application;[4]

(b) Analyzing the prospective borrower's income and debt and pre-qualifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

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[4] In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as compensable under RESPA, they should be identifiable and meaningful services akin to those identified in the IBAA letter including, for example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the

reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and

- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services – (b), (c), (d), (j), and (k) on the list above – to justify its fee, HUD would also look to see that meaningful counseling – not steering – is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;

- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*

- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed.[5] However, the IBAA letter responded to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans.[6]

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished

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[5] In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only non-counseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

[6] In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $200.

or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage [*10086] broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods

or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.[7] If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93-866, at 6551.)

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are

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[7] HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a

combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there may be no payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.)[8]

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[8] The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (See 24 CFR 3500.14(e).)

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24 CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted.[9] Also, the Department has seen [*10087] examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the

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[9] This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

mortgage broker should identify that they are mortgage broker fees from the borrower.[10]

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to

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[10] HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if these additional disclosures were included in future forms.

the interest rate and points for the loan and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a

loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated with home-secured credit transactions

and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this **Amended** Statement of Policy under Executive Order 12866, *Regulatory Planning and Review.* OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: ~~February 22, 1999. William C. Apgar~~, July , 2001.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. ~~99-4921 Filed 2-26-99; 8:45 am] BILLING CODE 4210-27-P~~ Filed; : am]

What we are asking for:

We are not asking for elimination of class actions or wiping out liability. The clarification is only a piece of evidence as to what HUD thinks the law is.

What we are offering:

Our suggestion: A mandatory contract between the broker and the borrower that clearly establishes the amount of the payment and the method of payment. Not just disclosure, but a binding legal contract.

Why this works for Consumers and the Senate.

First the relief we are asking for is not nearly as far reaching as consumers and the Senate may have believed. They appear to think that we wanted HUD to wipe out liability and class actions. This is not what the clarification does.

Second, the mandatory contract we are proposing directly addresses the consumer and senate issues: How much the broker is getting and what the relationship is.

The Senate and consumers do not want the retroactive relief, but they do want a better system going forward. So it's a fair compromise, especially since the relief is simply a clarification and does not have the effect of ending any suits or cutting off anybody's legal rights.

How to do it:

Issue the clarification as we have proposed in a policy statement published in the federal register. Simultaneously, issue an interim rule with the new broker fee agreement effective in 30 days. This takes care of the desire of consumers and the senate to move both relief and prospective changes simultaneously.

DRAFT **DRAFT** **DRAFT**

Mortgage Broker Fee and Disclosure Agreement

In the following: I = applicant; You = mortgage broker

Mortgage Broker Services. You are duly authorized and prepared to assist me in arranging mortgage financing for my home, and I engage you to provide such service. I understand that your services may include, but are not limited to the following:

- ξ Taking my personal financial information and helping me complete my loan application
- ξ Advising me about the different types of loan products available and demonstrating how closing costs and monthly payments could vary under each product
- ξ Collecting financial information such as tax returns and bank statements that are part of the application process
- ξ Initiating/ordering requests for mortgage and other loan verifications
- ξ Initiating/ordering appraisals, inspections or engineering reports
- ξ Providing me with required disclosures such as the truth-in-lending and good faith estimate disclosures
- ξ Assisting me in understanding credit problems
- ξ Performing such other services necessary to the completion of the loan application process

Amount of Broker Fee. I understand that, as compensation for your services, your total compensation from any and all sources will not exceed:

$ _____ or _____ points (one point equals I percent of the original principal balance of the mortgage loan obtained).

Method of Broker Fee Payment. I understand that my choice as to how I want to structure my loan transaction will affect how your compensation is paid:

- ξ ***If I want to minimize my interest rate,*** I may pay higher up-front points and fees and pay you directly.
- ξ ***If I want to minimize the cash I must bring to closing,*** I may pay some or all of your compensation indirectly through a higher interest rate in which case the lender will pay you directly in whole or in part.

Nature of the Relationship. In connection with this Broker Fee and Disclosure Agreement and any mortgage loan, you are acting as my agent, except where state law provides otherwise. Although you seek to assist me in meeting my financial needs, you do not distribute the products of all lenders or investors in the market and cannot guarantee the lowest price or best terms available in the market.

Termination. This agreement will continue until one of the following events occurs:

- ξ I fail to receive loan approval;
- ξ My loan closes;
- ξ I terminate your services;
- ξ You and I enter into a new Mortgage Broker Fee and Disclosure Agreement; or

ξ _____ days expire from the date of this agreement without any of the foregoing occurring.

Mortgage Broker Fee and Disclosure Acknowledgement

By signing below, we agree to the terms of this contract. Fees received under this agreement are legal and permissible under section 8 of the Real Estate Settlement Procedures Act and 24 CFR part 3500. The obligation to comply with the Mortgage Broker Fee and Disclosure Agreement rests solely with the mortgage broker, and no other entity shall be liable for any misrepresentation or non-performance of the brokers obligations under this agreement.

Signing this contract does not obligate me to obtain a mortgage loan through this mortgage broker, nor does it constitute mortgage loan approval.

**Applicant _____ Date _____
**Applicant _____ Date _____
_____ Date _____
Mortgage Broker Signature
Mortgage Broker License No. (where applicable) _____

[Delivery. [Rule will provide that agreement must be delivered to borrower within three (3) business days of broker taking loan application.]

United States Library of Congress

S 2223
Introduced in Senate
June 25, 1998

To provide a moratorium on certain class actions relating to the **Real Estate Settlement** Procedures Act of 1974.

IN THE SENATE OF THE UNITED STATES
June 25, 1998

Mr. GRAMS (for himself, Mr. FAIRCLOTH, Mr. BRYAN, Mr. THURMOND, Mr. BREAUX, Mr. ALLARD, Mr. AKAKA, Mr. BROWNBACK, Mr. INOUYE, Mr. DOMENICI, Mr. REID, Mr. GREGG, Mr. ASHCROFT, Mr. BENNETT, Mr. MACK, Mr. MCCAIN, and Mr. ENZI) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To provide a moratorium on certain class actions relating to the **Real Estate Settlement** Procedures Act of 1974.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the 'Mortgage Litigation Reform Act of 1998'.

Sec. 2. MORATORIUM.

Section 16 of the **Real Estate Settlement** Procedures Act of 1974 (12 U.S.C. 2614) is amended –

(1) by inserting '(a) IN GENERAL- ' after 'SEC. 16.'; and

(2) by adding at the end the following new subsection:

'(b) **CLASS ACTION MORATORIUM-**

'(1) IN GENERAL- During the period beginning on the date of enactment of the Mortgage Litigation Reform Act of 1998 and ending on July 1, 1999, in any State or Federal civil action arising under this Act in which it is alleged that a payment of a thing of value was made by a lender to another lender or to a mortgage broker –

'(A) no party shall serve or cause to be served, or be required to respond to, any discovery concerning any class certification issue;

'(B) no Federal or State court may enter any order –

'(i) certifying any class, other than an order certifying any class directly in connection with the settlement and compromise of any action; or

'(ii) imposing any sanction on any party for failing to comply with any discovery seeking information concerning any class certification issue; and

'(C) all Federal and State courts shall stay all further proceedings in any such action in which an

order certifying any class has been entered on or after January 1, 1998, for any purpose other than indirect connection with the settlement and compromise of any such action.

'(2) NO EFFECT ON OTHER ACTIONS- Nothing in this subsection shall be construed to limit or affect any civil action arising under this Act that is not brought by or on behalf of a class.'.

1998 CONG US S 2223

United States Library of Congress

HR 1283
Introduced In House
April 10, 1997

To provide a moratorium on certain class action lawsuits relating to the **Real Estate Settlement** Procedures Act of 1974.

IN THE HOUSE OF REPRESENTATIVES
April 10, 1997

Mr. EHRLICH (for himself, Mr. NEY, Mr. FOX of Pennsylvania, Mr. LIPINSKI, Mr. BACHUS, Mr. BARR of Georgia, Mr. METCALF, Mr. BAKER, Mrs. KELLY, Mr. LATOURETTE, Mr. SNOWBARGER, Mr. KING, Mr. HEFLEY, Mr. CHABOT, Mr. JONES, Mr. INGLIS of South Carolina, and Mr. NEWMANN, Mr. RAMSTAD, and Mr. WELLER) introduced the following bill; which was read twice and referred to the Committee on Banking and Financial Services, and in addition to the Committee on the Judiciary, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned

A BILL

To provide a moratorium on certain class action lawsuits relating to the **Real Estate Settlement** Procedures Act of 1974.

Be in enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the '**Real Estate Settlement** Procedures Act Class Action Relief of 1997'.

Sec. 2. MORATORIUM.

Section 16 of the **Real Estate Settlement** Procedures Act of 1974 (12 U.S.C. 2614) is amended –

(1) by inserting '(a) IN GENERAL- ' after 'SEC. 16.'; and

(2) by adding at the end the following new subsection:

'(b) **CLASS ACTION MORATORIUM-** During the period beginning on the date of enactment of the **Real Estate Settlement** Procedures Act Class Action Relief Act of 1997 and ending on December 31, 1998, in any State or Federal civil action or lawsuit arising under this Act in which it is alleged that a payment of a thing of value was made by a lender to another lender or to a mortgage broker –

'(1) no party shall serve or cause to be served, or be required to respond to, any discovery concerning any class certification issue;

'(2) no State or Federal court may enter any order –

'(A) certifying any class, except an order certifying any class directly in connection with the settlement and compromise of any action; or

'(B) Imposing any sanctions on any party for failing to comply with any discovery seeking information concerning any class certification issue; and

'(3) all State and Federal courts shall stay all further proceedings in any such action in which an order certifying any class has been entered on or after January 1, 1996, for any purpose other than indirect connection with the settlement and compromise of any such action.'.

1997 CONG US HR 1283

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12 U.S.C. § 2601. Congressional findings and purpose

(a) The Congress finds that significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. The Congress also finds that it has been over two years since the Secretary of Housing and Urban Development and the Administrator of Veterans' Affairs submitted their joint report to the Congress on "Mortgage Settlement Costs" and that the time has come for the recommendations for Federal legislative action made in that report to be implemented.

(b) It is the purpose of this chapter to effect certain changes in the settlement process for residential real estate that will result –

(1) in more effective advance disclosure to home buyers and sellers of settlement costs;

(2) in the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services;

(3) in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance; and

(4) in significant reform and modernization of local record-keeping of land title information.

12 U.S.C. § 2607. Prohibition against kickbacks and unearned fees

* * *

(d) Penalties for violations; joint and several liability; treble damages; actions for injunction by Secretary and by State officials; costs and attorney fees; construction of State laws

(1) Any person or persons who violate the provisions of this section shall be fined not more than $10,000 or imprisoned for not more than one year, or both.

(2) Any person or persons who violate the prohibitions or limitations of this section shall be jointly and severally liable to the person or persons charged for the settlement service involved in the violation in an amount equal to three times the amount of any charge paid for such settlement service.

(3) No person or persons shall be liable for a violation of the provisions of subsection (c)(4)(A) of this section if such person or persons proves by a preponderance of the evidence that such violation was not intentional and resulted from a bona fide error notwithstanding maintenance of procedures that are reasonably adapted to avoid such error.

(4) The Secretary, the Attorney General of any State, or the insurance commissioner of any State may bring an action to enjoin violations of this section.

(5) In any private action brought pursuant to this subsection, the court may award to the prevailing party

the court costs of the action together with reasonable attorneys fees.

(6) No provision of State law or regulation that imposes more stringent limitations on controlled business arrangements shall be construed as being inconsistent with this section.

[LOGO]

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

December 17, 1999

OFFICE OF THE GENERAL COUNSEL

The Honorable Bruce F. Vento
U.S. House of Representatives
Washington, DC 20515-2304

Dear Representative Vento:

This is in response to your letter dated December 7, 1999, asking three questions on behalf of your constituents regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, you ask: (1) whether, in its Statement of Policy 1999-1 (64 Fed.Reg. 10084), HUD intended to change existing law and create a new less stringent legal standard; (2) what factors HUD examines in determining whether payments to mortgage brokers are legal under RESPA; and (3) whether HUD intended the Police Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage

brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In

applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a compensable service. 64 Fed.Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed.Reg. 10087.

Finally, the preamble to the Policy Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,

/s/ Gail W. Laster
Gail W. Laster
General Counsel

[LOGO]

U.S. DEPARTMENT OF HOUSING
AND URBAN DEVELOPMENT
WASHINGTON, D.C. 20410-0500

OFFICE OF THE GENERAL COUNSEL

MAR 21, 2000

The Honorable Richard Shelby
United States Senate
Washington, D.C. 20510-0103

Dear Senator Shelby:

I regret the delay in responding to your letter dated November 19, 1999. In this response we answer three questions from your constituent, Mr. Leonard V. Zumpano, Director of the Alabama Research and Education Center at the University of Alabama, regarding lender payments to mortgage brokers under the Real Estate Settlement Procedures Act (RESPA). Specifically, Mr. Zumpano asks: (1) whether HUD intended for its recent Statement of Policy on this subject to create a new legal standard or to change existing law; (2) whether in order to be legal under RESPA, lender payments must be paid in exchange for goods, facilities or services actually provided by the broker, or whether "reasonable" payments are legal regardless of the purpose of the fees; and (3) whether HUD intends for its Policy Statement to weaken the referral fee prohibitions contained in RESPA.

Regarding the first question, as requested in the Conference Report on the Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No.

105-769), on March 1, 1999, HUD issued Statement of Policy 1999-1 regarding the legality of mortgage lender payments to mortgage brokers under RESPA. The preamble to the Statement of Policy expressly states that it "provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law." 64 Fed.Reg. 10084. In accordance with its express language, HUD did not intend for the Policy Statement to create a new legal standard or to change existing law.

As to the second question, the Policy Statement makes clear that HUD does not consider lender payments to mortgage brokers illegal *per se*. The Policy Statement articulates a two-part test to determine the legality of yield spread or other payments to mortgage brokers from lenders. HUD's position is that for a payment from a lender to a mortgage broker to be permissible under RESPA: (1) goods or facilities must have been furnished or services must have been performed "for" – i.e., in exchange for – the compensation paid to the broker; and (2) the broker's compensation must be reasonably related to the value of the services performed, or the goods or facilities provided, by the broker. 64 Fed.Reg. 10084. Regarding the first test, the Policy Statement sets out the minimum types and extent of services that a mortgage broker must perform in order to justify compensation to the broker. The Policy Statement then provides that "[t]he fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal." 64 Fed.Reg. 10085-6. Accordingly, the mere performance of any service by a mortgage broker is not in itself sufficient to

establish that the payment to the broker was made in exchange for those services. "The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." 64 Fed.Reg. 10086. In applying this second test, the total compensation from the lender and the borrower should be scrutinized to assure that the payment is reasonably related to goods, facilities, or services furnished or performed. 64 Fed.Reg. 10084 and 10086. Moreover, the Policy Statement also makes clear that in analyzing whether any transaction under RESPA and its regulations involves compensation for "goods," a mortgage loan is not a "good," and that the referral of a loan is not a compensable service. 64 Fed.Reg. 10085 and 10086. HUD stated that mortgage brokers and lenders could better demonstrate the reasonableness of mortgage broker compensation if, at the time a consumer first discusses the possibility of a loan with a broker, the broker discloses the nature of its services and the various methods of its compensation. At a minimum, mortgage brokers are required to clearly label and properly estimate their fees on the Good Faith Estimates. 64 Fed.Reg. 10087.

Finally, the preamble to the Police Statement affirms that "[t]he Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers." 64 Fed.Reg. 10082. Moreover, it says that "[t]he fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA." 64 Fed.Reg. 10084. HUD, therefore, never intended for its Policy Statement to weaken the prohibitions contained in Section 8 of RESPA and indeed, in

elucidating the tests for when fees could be legal, sought to establish a brighter line defining illegal conduct. HUD is committed to assuring that consumers receive all of the protections that Congress afforded under RESPA.

I appreciate your interest in the Department's programs. If I can be of further assistance, please contact me.

Sincerely,
/s/ Gail W. Laster
Gail W. Laster
General Counsel

COLLECTIONS WORLD [LOGO]

Thursday, July 12, 2001

Lenders Ask HUD to Clarify Legality of Yield Spread Premiums

WASHINGTON

Mortgage lenders are urging the Department of Housing and Urban Development to issue a clarification of its yield-spread premium policy statement in the wake of the Culpepper decision by the U.S. Court of Appeals in Atlanta.

"We are making a case to HUD," said Howard Glaser, who is in charge of government affairs at the Mortgage Bankers Association.

The MBA contends that the appeals court misinterpreted the HUD policy statement when it cleared the way for a class action lawsuit (Culpepper v. Irwin Mortgage Corp.) to go [sic] trial.

YSP premiums are used in 50% of all mortgage transactions and the appeals court has ruled that YSPs are de facto illegal, Mr. Glasersaid [sic].

If HUD issues a clarification, it would provide some comfort for wholesale lenders who continue to compensate mortgage brokers through the payment of YSPs. "But more importantly, it would dilute the potential impact of Culpepper with other courts," said Larry Platt, a partner at the Washington law firm of Kirkpatrick & Lockhart.

Meanwhile, Irwin Mortgage, based in Indianapolis, is expected to file a request for all the circuit judges on the Atlanta appeals court to rehear the Culpepper case.

The payment of yield-spread premiums allows brokers to roll the cost of points into the interest rate of a loan, as well as their fees for originating the loan. The HUD policy statement says YSPs are not illegal per se, provided the fees are reasonable and are related to services provided.

YSPs also reduce the amount of cash borrowers have to bring to the closing table. And by rolling other closing costs into the loan amount, lenders can offer consumers "zero-cost" loans.

"Absent a reversal, MBA believes the (Culpepper) decision will increase the cost of credit to consumers and sharply curtail, if not eliminate, an important mechanism for providing borrowers with needed flexibility in structuring their mortgage transactions," the MBA said in a statement.

The MBA and others are concerned that the Culpepper decision will trigger a flood of lawsuits against lenders.

"If HUD does not issue a clarification relatively quickly, we will have to seek emergency legislative relief," said Wright Andrews, a Washington lobbyist with Butera & Andrews.

Getting Congress to act would not be easy, he admitted, but the litigation could be "devastating to a whole lot of companies." Several industry officials noted that getting legislative relief would be nearly impossible and it would take too long to be effective.

Besides the potential liability, wholesaler lenders also have to worry about market share if they lose the ability

to pay YSPs, according to mortgage industry expert Allen Hardester, who is based in Columbia, Md.

"YSPs are just an easy way for wholesalers to induce brokers to deliver loans and it can be abused," Mr. Hardester said.

The general counsel for the National Association of Mortgage Brokers believes something has to be done quickly to blunt the impact of the Culpepper decision and he believes HUD shares that sense of urgency.

"HUD has been very responsive," said NAMB general counsel Robert Lotstein of the Washington law firm of Lotstein Buckman.

"We are confident, based on the new administration and the people appointed, that they are going to be responsive to this problem" Mr. Lotstein said.

He also noted class action lawyers have started to advertise for clients so that they can file new cases against lenders. *(7/12)*

Only the Westlaw citation is currently available.

United States Court of Appeals, Second Circuit.

CATSKILL MOUNTAINS CHAPTER OF TROUT UNLIMITED, INC., Theodore Gordon Flyfishers, Inc., Catskill-Delaware Natural Water Alliance, Inc., Federated Sportsmen's Clubs of Ulster County, Inc. and Riverkeeper, Inc., Plaintiffs-Appellants,

v.

The CITY OF NEW YORK, New York City Department of Environmental Protection and Joel A. Miele, Sr., Commissioner of Department of Environmental Protection, Defendants-Appellees.

No. 00-9447.

Argued May 25, 2001.
Decided Oct. 23, 2001.

Karl S. Coplan, Pace Environmental Litigation Clinic, Inc. (Basil B. Seggos, on the brief), White Plains, NY, for Appellants.

Ellen S. Ravitch, Office of the Corporation Counsel of the City of New York (Michael D. Hess, Stephen J. McGrath, Hillary Meltzer, and William S. Plache, on the brief), New York, NY, for Appellees.

Before WALKER, Chief Judge, KATZMANN and CUDAHY,* Circuit Judges.

JOHN M. WALKER, JR., Chief Judge:

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* The Honorable Richard D. Cudahy of the United States Court of Appeals for the Seventh Circuit, sitting by designation.

Plaintiff environmental organizations Catskill Mountains Chapter of Trout Unlimited, Inc., Theodore Gordon Flyfishers, Inc., Catskill-Delaware Natural Water Alliance, Inc., Federated Sportsmen's Clubs of Ulster County, Inc., and Riverkeeper, Inc. (collectively "Catskill") appeal from an October 6, 2000 order of the United States District Court for the Northern District of New York (Frederick J. Scullin, Jr., *Chief District Judge*) granting a motion to dismiss under Fed.R.Civ.P. 12(b)(6) made by defendants City of New York, New York City Department of Environmental Protection, and Joel A. Miele, Sr., Commissioner of the Department of Environmental Protection (collectively "New York City" or "the City"). We conclude that some of Catskill's claims should not have been dismissed and those that were properly dismissed should have been dismissed without prejudice. Accordingly, we reverse in part, vacate in part, and remand for further proceedings consistent with this opinion.

BACKGROUND

Since before World War II, New York City has operated Schoharie Dam and Reservoir in the Catskill Mountains, to provide drinking water for New York City. Water is diverted south from the Schoharie Reservoir ("the Reservoir") through the Shandaken Tunnel ("the Tunnel") for several miles and released into Esopus Creek ("the Creek"), which in turn empties into Ashokan Reservoir. The transfer of water from the Reservoir to Esopus Creek and Ashokan Reservoir facilitates its delivery to New York City for use as drinking water.

Absent the tunnel, water leaving the Reservoir would flow north in Schoharie Creek, join the Mohawk River, and flow into the Hudson River. Water from Esopus Creek, on the other hand, makes its way southeast to the Hudson by way of Ashokan Reservoir. Schoharie Reservoir and Esopus Creek are hydrologically connected only insofar as both are tributaries of the Hudson. Under natural conditions, water from the Schoharie Reservoir would never reach Esopus Creek.

Plaintiffs-appellants primarily represent recreational users of Esopus Creek. On November 20, 1998, Catskill sent a letter to the City, the United States Environmental Protection Agency ("EPA"), and the New York State Department of Conservation ("NYSDEC"), indicating Catskill's intention to file suit in district court under the federal Clean Water Act ("CWA," "the Act"), 33 U.S.C. § 1251 et seq. The Act permits aggrieved parties to bring civil actions to enforce certain of the statute's requirements against alleged violators. *See* 33 U.S.C. § 1365 ("Citizen suits").

On March 31, 2000, Catskill filed a complaint in district court alleging that the City, as owner and operator of the Schoharie Reservoir and Shandaken Tunnel, was in violation of 33 U.S.C. § 1311(a), which prohibits "the discharge of any pollutant" unless those discharges are conducted in accordance with a duly issued discharge permit. 33 U.S.C. § 1311(a) (citing permit requirement in 33 U.S.C. § 1342). Catskill alleged that the Tunnel discharges pollutants in the form of "suspended solids," "turbidity," and heat into Esopus Creek. They alleged that the suspended solids and turbidity are the result of

earth-disturbing activities within the Reservoir's watershed that produce fine, red-clay sediments in the Reservoir. They further alleged that the discharges cause the Creek to violate state water quality standards for turbidity and temperature. Esopus Creek, Catskill contended, is naturally clearer and cooler than the water entering it from the Tunnel and supports "one of the premier trout fishing streams in the Catskill Region."

The City responded by moving under Fed.R.Civ.P. 12(b)(1) that the case be dismissed for want of jurisdiction because Catskill's notice-of-intent- to-sue letter ("NOI letter") was inadequate, and a proper NOI letter, they argued, is a jurisdictional prerequisite for a CWA citizen suit. The City also moved pursuant to Fed.R.Civ.P. 12(b)(6) that the case be dismissed because, although the City admits that it lacks a permit to discharge into Esopus Creek, it need not obtain one because its releases do not constitute "discharges" as defined by the CWA.

The district court denied the City's Rule 12(b)(1) motion, concluding that Catskill's NOI letter comported with the requirements of the Act and EPA regulations, but granted the Rule 12(b)(6) motion. It found that, as a matter of law, the Reservoir and Tunnel did not effect an "addition" of a pollutant to the Creek, as required to trigger the CWA's permit requirement. *See* 33 U.S.C. § 1362(12) (defining "discharge of a pollutant" to mean "any addition of any pollutant to navigable waters from any point source"). Catskill appealed.

DISCUSSION

The City makes two arguments in support of the district court's dismissal. It first argues that the district court and this court lack subject matter jurisdiction over the case because Catskill's NOI letter, required by the CWA's citizen suit provision, was inadequate and that a proper NOI letter is a prerequisite to the court's subject-matter jurisdiction. Second, the City reiterates its successful argument in the district court, that the complaint failed to state a claim, because Shandaken Tunnel does not effect an "addition" of a pollutant, as required to constitute a "discharge" for which a permit must be sought.

We agree with the City that the NOI letter did not provide adequate notice of Catskill's eventual claim regarding thermal discharges, but find the letter adequate to notify the City of the balance of Catskill's claims. The district court should have dismissed the thermal discharge claims without prejudice, however, and we therefore vacate the judgment with respect to those claims and remand with direction to dismiss them without prejudice to refiling after submission of a conforming NOI letter and after the 60-day delay required by the CWA. We also conclude that the district court erred in dismissing Catskill's complaint on the theory that Shandaken Tunnel does not "discharge" pollutants into Esopus Creek. We therefore reverse the judgment on the remaining claims and remand the case for further proceedings.

I. The Statutory Framework

We begin with an overview of the regulatory regime. The CWA's primary function is to regulate the discharge of pollutants into navigable waters. Although the Act contains the lofty goal of eliminating water pollutant discharges altogether, *see* 33 U.S.C. § 1251(a)(1), the regulatory regime it creates requires principally that discharges be regulated by permit, not prohibited outright. The Act mandates that "the discharge of any pollutant by any person shall be unlawful," 33 U.S.C. § 1311(a), "[e]xcept as in compliance" with other provisions of the statute, one of which establishes a permitting program, the "National Pollutant Discharge Elimination System" ("NPDES"), 33 U.S.C. § 1342. Section 1342 in turn provides for the issuance of discharge permits ("NPDES permits") that allow the holder to discharge pollutants at levels below thresholds incorporated in the permit. 33 U.S.C. § 1342(a); *see also* 40 C.F.R. § 122.1 et seq. In New York, the NPDES program is administered by NYSDEC and referred to as the State Pollution Discharge Elimination System ("SPDES"). *See* 33 U.S.C. § 1342(b) (authorizing state implementation of the NPDES program); N.Y. Envtl. Conserv. Law §§ 17-0105(13), 17-0701.

In the instant case, Catskill alleges that the City has been violating the CWA's unpermitted discharge prohibition by discharging water containing pollutants from Shandaken Tunnel into Esopus Creek without first obtaining an NPDES permit. The Act defines "discharge of a pollutant" to include "any addition of any pollutant to navigable waters from any point source." 33 U.S.C. § 1362(12). The Act defines "pollutant," "navigable

waters," and "point source," 33 U.S.C. § 1362(6), (7), and (14), but the crux of this appeal is the meaning of "addition," which the Act does not define.

In addition to providing for enforcement by state agencies and the EPA, the CWA allows private parties to enforce its mandates, including the prohibition of unpermitted discharges in § 1311(a), against alleged violators in so- called "citizen suits." *See* 33 U.S.C. § 1365(a)(1), (f). An aggrieved plaintiff may bring a civil action for specific relief, such as the imposition of particular compliance measures, or civil penalties payable to the treasury, *see* 33 U.S.C. § 1365(a), and may recover attorney's fees, *see* 33 U.S.C. § 1365(d). At least 60 days prior to filing, however, the prospective plaintiff must provide notice of its claims to the potential defendant, the EPA, and the state in which the violations allegedly occurred. *See* 33 U.S.C. § 1365(b)(1)(A). If a competent state or federal enforcement agency brings a civil enforcement action against the defendant prior to the citizen complaint's being filed, or an administrative enforcement proceeding prior to the plaintiff's NOI letter, the citizen suit is preempted and must be dismissed. *See* 33 U.S.C. §§ 1319(g)(6), 1365(b)(1)(B).

II. Catskill's Notice of Intent to Sue

The City claims that Catskill's NOI letter was inadequate because, while it was provided in a timely fashion to the proper parties, the letter failed to give the City adequate notice of the claims that Catskill intended to bring. Catskill's complaint as filed alleged discharges of

"a high level of turbidity," "suspended solids," and "elevated temperatures." Yet the NOI letter stated only that the City has discharged "pollutants in the form of Total Suspended Solids and Settleable Solids into the Esopus Creek." The City argues that by failing to provide notice of the claims of turbidity and thermal discharges ultimately alleged in the complaint, the NOI letter was fatally defective, requiring the suit to be dismissed. Although the district court did not rely on this theory in dismissing the complaint, we may affirm on a basis not relied on by the district court. *See Name.Space, Inc. v. Network Solutions, Inc.*, 202 F.3d 573, 584 (2d Cir.2000). We conclude that the NOI letter failed to notify the City of Catskill's thermal discharge claims, but that fact does not invalidate Catskill's complaint in its entirety. Accordingly, we hold that those claims were properly dismissed.

The CWA does not describe the content of the required notice, but directs that "[n]otice . . . shall be given in such manner as the Administrator shall prescribe by regulation." 33 U.S.C. § 1365(b). The EPA has adopted such regulations, which mandate, *inter alia*, as follows:

> Notice regarding an alleged violation of an effluent standard or limitation or of an order with respect thereto, shall include sufficient information to permit the recipient to identify the specific standard, limitation, or order alleged to have been violated, the activity alleged to constitute a violation, the person or persons responsible for the alleged violation, the location of the alleged violation, the date or dates of such violation, and the full name, address, and telephone number of the person giving notice.

40 C.F.R. § 135.3(a). In the past, we have refused to "allow form to prevail over substance" in considering the content required of an NOI letter, and have looked instead to what the particular notice given may reasonably be expected to accomplish. *Dague v. City of Burlington*, 935 F.2d 1343, 1354 (2d Cir.1991), *rev'd in part on other grounds*, 505 U.S. 557, 112 S.Ct. 2638, 120 L.Ed.2d 449 (1992).

The City contends that the EPA regulations require a potential plaintiff to include in an NOI letter each separate pollutant that will be alleged in a subsequent complaint as the basis of a violation of the Act. At least one circuit has adopted such a rule. *See Pub. Interest Research Group v. Hercules*, 50 F.3d 1239, 1248 (3d Cir.1995). On this theory, for example, a plaintiff could not bring suit for discharges of mercury, lead, and copper if the NOI letter alleged violations based only on discharges of copper. In that case, the claims of copper violations would stand, but the claims based on mercury and lead discharges would need to be dismissed. We agree with the City that such a rule logically follows from the regulatory scheme and therefore adopt it.

The EPA regulations require that an NOI letter "include sufficient information to permit the recipient to identify the specific standard, limitation, or order alleged to have been violated, [and] the activity alleged to constitute a violation." 40 C.F.R. § 135.3(a). We believe that to be "sufficient," the information provided must include the pollutant alleged to be the basis of a violation subsequently alleged in the complaint.

Because each discharge of a pollutant represents a distinct violation of the Act, *see* 33 U.S.C. § 1311(a) ("the discharge of any pollutant . . . shall be unlawful"); *Atl. States Legal Found., Inc. v. Tyson Foods, Inc.*, 897 F.2d 1128, 1138 n. 19 (11th Cir.1990), identification in an NOI letter of a pollutant allegedly discharged is essential to provide adequate notice of the alleged violation. Discharges of mercury and lead, for instance, could be distinct violations, each subject to penalties of up to $25,000 per day. *See* 33 U.S.C. §§ 1319(d), 1365(a). To provide adequate notice of each violation that will be targeted in the citizen suit, the NOI letter must differentiate pollutants from nonpollutants and one pollutant from another. The rationale for such a rule is most apparent in the context of a suit alleging discharges in excess of NPDES permit limitations, in which the defendant may be discharging some pollutants lawfully and others unlawfully. To enable the defendant to identify each violation that will be alleged, then, the NOI letter must specify each pollutant unlawfully discharged that will be alleged in a subsequent complaint. The principle applies equally where, as here, the defendant has failed altogether to obtain a permit. To state a claim based on unpermitted discharges, the plaintiff must allege some pollutant that was discharged without a permit. It follows, then, that to the extent the plaintiff intends to prosecute multiple violations involving multiple pollutants, each pollutant that will be the basis of such a claim must be set forth in the NOI letter.

The policies underlying the NOI requirement are furthered by this rule. The notice and 60-day delay requirements allow a potential defendant to identify its own

violations and bring itself into compliance voluntarily, thus making a costly lawsuit unnecessary. *See Hallstrom v. Tillamook County*, 493 U.S. 20, 29-30, 110 S.Ct. 304, 107 L.Ed.2d 237 (1989); *Dague*, 935 F.2d at 1351; *see also Gwaltney of Smithfield, Ltd. v. Chesapeake Bay Found.*, 484 U.S. 49, 108 S.Ct. 376, 98 L.Ed.2d 306 (1987) (holding that if the defendant ceases its violations prior to the filing of the complaint, the action is barred). Specific knowledge of the pollutants allegedly discharged unlawfully makes it easier for the defendant to promptly rectify the problem. *Cf. Atl. States Legal Found., Inc. v. Stroh Die Casting Co.*, 116 F.3d 814, 819-20 (7th Cir.1997) ("In practical terms, the notice must be sufficiently specific to inform the alleged violator about what it is doing wrong, so that it will know what corrective actions will avert a lawsuit. . . . The key to notice is to give the accused company the opportunity to correct the problem.").

The notice and delay requirements are also designed to allow the enforcer of first resort, the EPA or the appropriate state agency, to bring its own enforcement action, *see Hallstrom*, 493 U.S. at 29, which would preempt the citizen lawsuit, *see* 33 U.S.C. § 1365(b)(1)(B). Inclusion of each pollutant forming the basis of an alleged violation better allows enforcement agencies to identify and prosecute a potential defendant's violations, giving effect to Congress's intention that citizen enforcers supplement, not supplant, public enforcement. *See id.* (citing *Gwaltney*, 484 U.S. at 60).

Accordingly, we hold that an NOI letter must identify with reasonable specificity each pollutant that the defendant is alleged to have discharged unlawfully. Failure to

do so will justify a district court's dismissing claims based on pollutants not properly noticed.

Turning to the case at hand, we conclude that Catskill's NOI letter adequately notified the City of some but not all of the violations subsequently alleged in the complaint. The district court found, and Catskill argues on appeal, that inclusion of "suspended solids" and "settleable solids" was sufficient to notify the City of Catskill's claims of turbidity and thermal discharges, because of the logical and empirical associations between suspended solids on the one hand and turbidity and thermal discharges on the other. We agree with respect to Catskill's claims of turbidity discharges, but not with respect to thermal discharges.

Turbid water, by definition, is water carrying high levels of solids in suspension. The presence of elevated levels of suspended solids inevitably produces turbidity. "Turbid" is defined as "having the lees or sediment disturbed: thick or opaque with matter in suspension." *Webster's Third New International Dictionary* 2464 (1981). Water cannot be turbid without suspended solids, and some level of turbidity is inherent where suspended solids are present. Because each logically depends on the other, notice of discharges of suspended solids is sufficient to notify of an eventual claim based on discharges of "turbidity."

On the other hand, the relationship between suspended solids and temperature is one of association, not identity. To be sure, increased turbidity often produces increased water temperature. Particles suspended in water absorb heat, raising the temperature of the water.

But the presence of suspended solids does not inevitably raise water temperature. The effect of suspended solids on temperature depends on a third variable, radiant heat, usually in the form of sunlight. Increased turbidity in a cold, dark place may not affect the temperature of the water at all, or may do so only infinitesimally, because no source of radiant heat is present. As a result, unlike suspended solids and turbidity, there is no necessary relationship between suspended solids and increased temperature. The relationship is only one of frequent association under ordinary circumstances.

Accordingly, to be sufficient, the allegations in an NOI letter must suggest that these ordinary circumstances were also prevalent. Where alleged circumstances indicate that suspended solids and increased temperature are very likely to be associated, notice of suspended solids may be sufficient to notify a reasonable person of a thermal discharge claim. In the instant case, Catskill's NOI letter does not state that such circumstances were prevalent.

For the foregoing reasons, we hold that Catskill's claims of unpermitted thermal discharges were properly dismissed under Rule 12(b)(6). However, those claims should have been dismissed without prejudice. Thus we vacate so much of the judgment as dismissed Catskill's thermal discharge claims with prejudice and remand those claims with direction that they be dismissed without prejudice to refiling after full compliance with 33 U.S.C. § 1365(b)(1)(A).

III. Interbasin Transfer as a "Release" Under the CWA

As we have noted, the CWA prohibits, unless otherwise allowed by permit, "the discharge of any pollutant," 33 U.S.C. § 1311(a), which the Act defines to mean "any addition of any pollutant to navigable waters from any point source," 33 U.S.C. § 1362(12). The statute does not define "addition." The City argues that the release of water from Schoharie Reservoir into Esopus Creek is not an "addition," citing *National Wildlife Federation v. Gorsuch*, 693 F.2d 156 (D.C.Cir.1982), and *National Wildlife Federation v. Consumers Power Co.*, 862 F.2d 580 (6th Cir.1988), both of which accorded substantial deference to the EPA's position that the CWA's discharge permit requirement does not apply to discharges from dams. Catskill counters that the *Gorsuch* and *Consumers Power* courts accorded unjustified deference to the EPA's interpretation of "addition," that the cases are distinguishable on their facts, and that the City's conduct here qualifies as an "addition" under the plain meaning of that word. We agree with Catskill and accordingly reverse the district court and remand for further proceedings on Catskill's remaining claims.

A. The EPA's Position and the Proper Standard of Deference

In several policy statements made in opinion letters and reports to Congress in the 1970s and 1980s, the EPA took the position that dam releases should not be considered "discharges" under the CWA and thus NPDES

permits would not be required for those releases.[2] *See Gorsuch*, 693 F.2d at 167-69. This position was never formalized in a notice-and-comment rulemaking or formal adjudication under the Administrative Procedure Act, 5 U.S.C. §§ 553, 554, although the EPA subsequently reiterated its position in the *Gorsuch* and *Consumers Power* cases, as a defendant and amicus curiae, respectively. *See Consumers Power*, 862 F.2d at 583; *Gorsuch*, 693 F.2d at 165. Both courts rested their decisions on the conclusion that the EPA position deserved substantial deference and was reasonable. Given subsequent Supreme Court decisions governing judicial deference to federal agencies' constructions of the statutes that they implement, we hold that the EPA position is due less deference than that accorded it by the *Gorsuch* and *Consumers Power* courts.

In 1982, in *Gorsuch*, the District of Columbia Circuit deferred to the EPA's position that dam releases were not "additions" under the CWA, which it upheld as a reasonable construction of the statute. The *Gorsuch* plaintiffs had sued the EPA under 33 U.S.C. § 1365(a)(2), seeking a declaration that the EPA had a nondiscretionary duty to require NPDES permits from dam operators. After an extensive exegesis of the CWA's statutory text, structure, and legislative history, the court concluded that the EPA could reasonably conclude that dam releases were not

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[2] The original documents in which the EPA staked out its position were not included in the filings before this court and were not published in the usual sources of administrative law, the *Code of Federal Regulations* and the *Federal Register*. We accordingly base our discussion of the EPA's position on that included in the District of Columbia Circuit's comprehensive opinion in *Gorsuch*.

"additions." *See* 693 F.2d at 170-83. Notwithstanding the court's extensive investigation of legislative intent, its relied ultimately on deference to the agency:

> [W]e emphasize the narrowness of our decision. It is not our function to decide whether EPA's interpretation . . . is the best one or even whether it is more reasonable than the Wildlife Federation's interpretation. We hold merely that EPA's interpretation is reasonable, not inconsistent with congressional intent, and entitled to great deference; therefore, it must be upheld.

693 F.2d at 183. In 1988, the Sixth Circuit reached the same conclusion. *See Consumers Power*, 862 F.2d at 584-87.

If the EPA's position had been adopted in a rulemaking or other formal proceeding, deference of the sort applied by the *Gorsuch* and *Consumers Power* courts might be appropriate. Instead, the EPA's position is based on a series of informal policy statements made and consistent litigation positions taken by the EPA over the years, primarily in the 1970s and 1980s. Recent Supreme Court cases emphasize that such agency statements do not deserve broad deference of the sort accorded by the *Gorsuch* and *Consumers Power* courts.[3] *See United States v. Mead Corp.*, ___ U.S. ___, 121 S.Ct. 2164, 150 L.Ed.2d 292 (2001); *Christensen v. Harris County*, 529 U.S. 576, 120 S.Ct. 1655, 146 L.Ed.2d 621 (2000). In *Christensen*, the Supreme

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[3] *Consumers Power* expressly applied the standard of deference elaborated in *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984). *See* 862 F.2d at 584-85. *Gorsuch*, which predated *Chevron*, applied essentially the same degree of deference. *See* 693 F.2d at 166-67.

Court held that "[i]nterpretations such as those in opinion letters – like interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law – do not warrant *Chevron*-style deference." 529 U.S. at 587. "Instead," the Court continued, "interpretations contained in formats such as opinion letters are 'entitled to respect' . . . but only to the extent that those interpretations have the 'power to persuade.' " *Id.* (citation omitted). The Court consequently held that an opinion letter by the Department of Labor deserved only this form of limited deference in its interpretation of a provision of the Fair Labor Standards Act. *See id.*

Like the position taken by the Department of Labor in its opinion letter in *Christensen*, the EPA position on dam discharges has never been articulated in circumstances that would give it the "force of law." *Gorsuch* describes only a series of letters and several presentations for Congress in reports and testimony that outlined the EPA's position. *See Gorsuch*, 693 F.2d at 167-69. None of these sources come close to the sort of formal, binding articulation of an agency's views that would justify *Chevron* deference after *Christensen*. That the EPA later relied on its position in litigation does not alter our analysis; a position adopted in the course of litigation lacks the indicia of expertise, regularity, rigorous consideration, and public scrutiny that justify *Chevron* deference. *See Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 212, 109 S.Ct. 468, 102 L.Ed.2d 493 (1988); *Ball v. Memphis Bar-B-Q Co.*, 228 F.3d 360, 365 (4th Cir.2000); *S. Utah Wilderness Alliance v. Dabney*, 222 F.3d 819, 828 (10th Cir.2000).

However, as *Mead* and *Christensen* make clear, courts do not face a choice between *Chevron* deference and no deference at all. Administrative decisions not subject to *Chevron* deference may be entitled to a lesser degree of deference: the agency position should be followed to the extent persuasive. *See Mead*, ___ U.S. at ___ - ___, 121 S.Ct. at 2175-76 (citing *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944)). For the reasons that follow, however, we do not find the EPA's position to be persuasive.

B. Defining "Addition"

The EPA's position, upheld by the *Gorsuch* and *Consumers Power* courts, is that for there to be an "addition," a "point source must *introduce* the pollutant into navigable water from the outside world." *Gorsuch*, 693 F.2d at 165. We agree with this view provided that "outside world" is construed as any place outside the particular water body to which pollutants are introduced. Given that understanding of "addition," the transfer of water containing pollutants from one body of water to another, distinct body of water is plainly an addition and thus a "discharge" that demands an NPDES permit.

Both *Gorsuch* and *Consumers Power* essentially involved the recirculation of water, without anything added "from the outside world." Such recirculation, they concluded, could not be an "addition." In *Gorsuch*, water was released from a reservoir through a dam to the stream below. Plaintiffs complained that such a release amounted to a regulated discharge under the Act, requiring a permit. The reservoir above the dam and the stream

below, at least arguably, were sufficiently the "same" water that the release might not be considered an "addition"; nothing was introduced to the water that was not, in some sense, already there. *See* 693 F.2d at 174-75.

In *Consumers Power,* the defendant had withdrawn water from Lake Michigan, along with some surprised fish, for hydroelectric power generation. The water and fish were then returned to the Lake after passing through hydroelectric generators, which pureed some of the fish. The court found that returning the fish to the Lake, albeit in a different form, was not an "addition" because the fish had already been there. *See* 862 F.2d at 586. Indeed, the court concluded that "[t]he water which passes through the [defendant's hydropower works] never loses its status as water of the United States." *Id.* at 589. The navigable water was recirculated, but nothing was added. The Sixth Circuit therefore also concluded that the releases from the defendant's hydropower works were not "introduced from the outside world." *See id.* at 586. Beyond *Consumers Power,* several cases from other circuits, despite having found "additions" to have occurred, in dicta reiterated the *Gorsuch* holding. *See, e.g., Comm. to Save Mokelumne River v. E. Bay Mun. Util. Dist.,* 13 F.3d 305, 308-09 (9th Cir.1993); *United States v. Law,* 979 F.2d 977, 979 (4th Cir.1992) ("Where 'pollutants' exist[ ] *in the waters of the United States* before contact with these facilities, the mere diversion in the flow of the waters [does] not constitute 'additions' of pollutants to the water.").

The *Gorsuch* and *Consumers Power* decisions comport with the plain meaning of "addition," assuming that the water from which the discharges came is the same as that

to which they go.[4] If one takes a ladle of soup from a pot, lifts it above the pot, and pours it back into the pot, one has not "added" soup or anything else to the pot (beyond, perhaps, a *de minimis* quantity of airborne dust that fell into the ladle). In requiring a permit for such a "discharge," the EPA might as easily require a permit for Niagra Falls.

The present case, however, strains past the breaking point the assumption of "sameness" made by the *Gorsuch* and *Consumers Power* courts. Here, water is artificially diverted from its natural course and travels several miles from the Reservoir through Shandaken Tunnel to Esopus Creek, a body of water utterly unrelated in any relevant sense to the Schoharie Reservoir and its watershed. No one can reasonably argue that the water in the Reservoir and the Esopus are in any sense the "same," such that "addition" of one to the other is a logical impossibility. When the water and the suspended sediment therein passes from the Tunnel into the Creek, an "addition" of a "pollutant" from a "point source" has been made to a "navigable water," and the terms of the statute are satisfied.

In *Dague v. City of Burlington*, 935 F.2d 1343 (2d Cir.1991), we implicitly held the release of polluted water from one water body to a distinct, less-polluted water body to be an addition of pollutants to the latter. We

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[4] We need not and do not decide whether those courts were correct in accepting that the source and destination waters were identical and thus whether we would reach their conclusions if presented with the same facts.

concluded that a "discharge" had occurred where leachate from a landfill entered a pond and thereafter water from the pond, polluted with the leachate, flowed through a culvert into a surrounding marsh. We held that (1) the pond and marsh were different navigable waters; (2) the culvert was the relevant point source; and (3) the release of pond water through the culvert was a "discharge." We thus necessarily implied that the transfer of water from the pond to the marsh was an "addition." *Id.* at 1354-55. We also expressly rejected the defendant's argument that the water flowing from pond to marsh was not an "addition," noting that "[u]nder this argument, pollutants would be 'added' only when they are introduced into navigable waters for the first time." *Id.* at 1354.

The First Circuit reached a similar conclusion in *Dubois v. U.S. Dep't of Agriculture,* 102 F.3d 1273 (1st Cir.1996). In that case, a ski resort operator on Department of Agriculture property pumped water without a permit from a polluted river into a less-polluted pond to operate its snowmaking equipment. The court held that the transfer of polluted water from one water body to a distinct water body constitutes an "addition" of pollutants to the destination water body. The court emphasized that the two bodies of water, for all relevant purposes, were distinct: although water naturally flowed from the pond into the river, water would never naturally flow from river to pond. That difference made the pumping an "addition." *See id.* at 1296-97. The court distinguished *Gorsuch* and *Consumers Power* as involving movement of water within the same water body. *See id.* at 1299.

The City also argues that "addition" draws meaning from its association with the phrase "from a point source." This view misunderstands the import of the term "point source," which does not necessarily refer to the place where the pollutant was created but rather refers only the proximate source from which the pollutant is directly introduced to the destination water body. A pipe from a factory draining effluent into a navigable water is a point source, but the factory itself is not. This is clear from the text of the Act, which defines "point source," in relevant part, as

> any discernible, confined and discrete conveyance, including but not limited to any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, concentrated animal feeding operation, or vessel or other floating craft, from which pollutants are or may be discharged.

33 U.S.C. § 1362(14). Under most circumstances, a "pipe, ditch, channel, tunnel, [or] conduit" is unlikely to have created the pollutants that it releases, but rather transports them from their original source to the destination water body.

As a "tunnel," Shandaken Tunnel plainly qualifies as a point source. The tunnel itself need not have created the pollution; it is enough that it conveys the pollutants from their original source to the navigable water. *See United States v. Plaza Health Labs., Inc.*, 3 F.3d 643, 646 (2d Cir.1993). The City's proposed interpretation of "from a point source" is inconsistent with the CWA's definition of a point source.

Given the ordinary meaning of the CWA's text and our holding in *Dague*, we cannot accept the *Gorsuch* and *Consumers Power* courts' understanding of "addition," at least insofar as it implies acceptance of what the *Dubois* court called a "singular entity" theory of navigable waters, in which an addition to one water body is deemed an addition to all of the waters of the United States. *See Dubois*, 102 F.3d at 1296-97. We properly rejected that approach in *Dague*. Such a theory would mean that movement of water from one discrete water body to another would not be an addition even if it involved a transfer of water from a water body contaminated with myriad pollutants to a pristine water body containing few or no pollutants. Such an interpretation is inconsistent with the ordinary meaning of the word "addition."

Even if we were to conclude that the proper application of the statutory text to the present facts was sufficiently ambiguous to justify reliance on the legislative history of the statute, *see Blum v. Stenson*, 465 U.S. 886, 896, 104 S.Ct. 1541, 79 L.Ed.2d 891 (1984), that source of legislative intent would not help the City. The legislative history is silent on the meaning of "addition." *See Gorsuch*, 693 F.2d at 175. Instead, the City relies principally on evidence from other provisions of the statute that Congress sought (1) to target industrial and municipal wastes specifically, *see Plaza Health Labs.*, 3 F.3d at 647, and (2) to leave the regulation of water supply – and therefore dam and reservoir operations – to the states, *see* 33 U.S.C. § 1251(g) ("It is the policy of Congress that the authority of each State to allocate quantities of water

within its jurisdiction shall not be superseded, abrogated, or otherwise impaired by this [Act].").

Yet like many complex statutes (and the CWA is among the most complex), the CWA balances a welter of consistent and inconsistent goals. In contrast with the policies cited by the City, the CWA also expressly includes a broad and uncompromising policy of "restor[ing] and maintain[ing] the chemical, physical, and biological integrity of the Nation's waters." 33 U.S.C. § 1251(a). Artificially transferring water and pollutants between watersheds as the City has done here might well interfere with that integrity, as Catskill has alleged. Moreover, in the past we have applied the Act's proscriptions beyond industrial discharges. *See Concerned Area Residents for the Env't v. Southview Farm*, 34 F.3d 114 (2d Cir.1994) (involving discharges of agricultural waste).

In any event, none of the statute's broad purposes sways us from what we find to be the plain meaning of its text. *Cf. Plaza Health Labs.*, 3 F.3d at 647 ("The narrow questions posed by this case . . . may not be resolved merely by simple reference to [the CWA's] admirable goal[s]."). Where a statute seeks to balance competing policies, congressional intent is not served by elevating one policy above the others, particularly where the balance struck in the text is sufficiently clear to point to an answer. We find that the textual requirements of the discharge prohibition in § 1311(a) and the definition of "discharge of a pollutant" in § 1362(12) are met here.

CONCLUSION

The judgment of the district court is hereby reversed in part, vacated in part, and the case is remanded. We vacate so much of the judgment as dismissed Catskill's thermal discharge claims and remand with direction that those claims be dismissed without prejudice to refiling after full compliance with 33 U.S.C. § 1365(b)(1)(A). The remainder of the judgment dismissing the complaint is reversed and remanded for further proceedings consistent with this opinion. Costs are awarded to appellants.

MOTION FILED
DEC 19 2001

(3)

No. 01-695

In The

Supreme Court of the United States

IRWIN MORTGAGE CORPORATION,

Petitioner,

v.

JOHN ROBERT CULPEPPER, PATRICIA STARNES CULPEPPER, on Behalf of Themselves and All Others Similarly Situated, and BEATRICE N. HIERS, Individually and as a Representative of a Class of Similarly Situated Individuals,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF *AMICI CURIAE* MORTGAGE BANKERS ASSOCIATION OF AMERICA AND AMERICA'S COMMUNITY BANKERS IN SUPPORT OF PETITIONER

GREGORY P. DRESSER
Counsel of Record
JAMES F. MCCABE
MICHAEL J. AGOGLIA
MORRISON & FOERSTER LLP
425 Market Street
San Francisco, CA 94105-2482
(415) 268-7000

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

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MOTION FOR LEAVE TO FILE AMICI CURIAE BRIEF IN SUPPORT OF PETITIONER

The Mortgage Bankers Association of America ("MBA") and America's Community Bankers ("ACB") respectfully move this Court, pursuant to Rule 37.2(b), for leave to file the accompanying brief as amici curiae in this case in support of the petition for a writ of certiorari. In support of this motion, the MBA and ACB state:

1. Petitioner, Irwin Mortgage Corporation, has consented to the filing of the brief.

2. Respondents, John R. Culpepper, Patricia S. Culpepper, and Beatrice N. Hiers, by counsel, do not consent to the filing of the brief.

3. The MBA and ACB are two of the nation's largest associations of mortgage lenders, and their members are vitally interested in this case, as set out in the brief submitted with this motion. The MBA and ACB directly participated in the consultative process leading to the issuance by the Department of Housing and Urban Development ("HUD") of a formal interpretation of the legality of the practice at issue. That pronouncement, its interpretation by the court below, and HUD's subsequent clarification are central to the petition. The MBA and ACB believe that their industry experience generally, and their specific involvement in HUD's efforts to articulate the governing legal standard in cases involving yield

spread premiums on residential mortgages, offer a unique perspective that will aid the Court.

Respectfully submitted,

GREGORY P. DRESSER
Counsel of Record
JAMES F. MCCABE
MICHAEL J. AGOGLIA
MORRISON & FOERSTER LLP
425 Market Street
San Francisco, CA 94105-2482
(415) 268-7000

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INTEREST OF AMICI CURIAE

The Mortgage Bankers Association of America ("MBA") is a non-profit corporation headquartered in Washington, D.C. The MBA is the primary national trade association devoted exclusively to the field of mortgage and real estate finance. Mortgage banking firms make up the largest portion of the MBA's membership of 2,800 organizations engaged in originating, financing, selling, and servicing mortgages on residential and commercial properties.

America's Community Bankers ("ACB") is an independent national trade association that represents the nation's community banks of all charter types and sizes. ACB's members historically are primarily home mortgage lenders.

In 2001, mortgage lenders anticipate making $2 trillion in residential mortgages. Accordingly, the membership of the MBA and ACB (collectively "Amici") is vitally interested in the interpretation and application of the Real Estate Settlement Procedures Act ("RESPA"), 12 U.S.C. §§ 2601-2617. Specifically, Amici's membership is interested in the proper and consistent application of RESPA to the payment of yield spread premiums, and in avoiding needless litigation.

Amici support and endorse the arguments made by petitioner Irwin Mortgage Corporation ("Irwin") in its petition for a writ of certiorari.[1] Amici urge the Court to

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[1] Pursuant to Supreme Court Rule 37.6, the MBA and ACB certify that no counsel for a party authored any part of this brief,

grant the petition, vacate the judgment below, and remand to the Eleventh Circuit Court of Appeals to reconsider its decision in light of the Department of Housing and Urban Development's ("HUD") intervening 2001 Policy Statement,[2] which explicitly rejected the decision below, and clarified the governing test for liability in these cases. The Eleventh Circuit's decision in *Culpepper v. Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001) (*"Culpepper III"*), is contrary to over 50 district court decisions denying class certification in these cases, and will lead to inconsistent determinations under the same federal statute regarding the legality of a nationwide practice. As a consequence, *Culpepper III* creates the risk of catastrophic industry liability, and threatens to eliminate from the marketplace yield spread premiums and the critically important role they play in promoting home ownership.

SUMMARY OF ARGUMENT

Properly understood, yield spread premiums are a perfectly legitimate mechanism by which borrowers may choose to finance some or all of the compensation owed

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and no person or entity other than the MBA, ACB, and their members (not including Irwin) made a monetary contribution to the preparation or submission of the brief.

[2] Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b), 66 Fed. Reg. 53052-53059 (Oct. 18, 2001) (the "2001 Policy Statement").

to their mortgage broker for the admittedly valuable services the broker performs, in exchange for a slightly higher interest rate. For those borrowers who cannot otherwise pay the broker's compensation out of their own pocket, yield spread premiums represent an essential tool for obtaining otherwise unavailable home loans.

In the past seven years, approximately 200 putative nationwide class actions challenging the payment of yield spread premiums as violative of Section 8 of RESPA have inundated the nation's courts. Over 80 of those cases are still pending in district courts – most of which are heavily concentrated in the Eleventh Circuit.[3] In response, Congress specifically directed HUD, the agency generally charged with the interpretation of RESPA, to eliminate legal uncertainty in this area by issuing a clarifying policy statement regarding the legality of yield spread premiums. HUD then engaged in an intensive consultative process with a broad range of consumer groups, industry representatives – including the MBA and ACB – and other government agencies. 64 Fed. Reg. at 10084. These efforts culminated in HUD's 1999 Policy Statement[4], which set forth what HUD intended to be the binding test for RESPA liability in these cases.

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[3] Attached as Appendix A is a graphic representation of those putative nationwide class challenges to yield spread premiums under RESPA pending in district courts. As noted in Irwin's petition, both the Eighth and the Ninth Circuit Courts of Appeals are considering appeals in these cases.

[4] Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10080-10087 (March 1, 1999).

The *Culpepper III* decision found a passage in HUD's 1999 Policy Statement "ambiguous," and fashioned an entirely new liability standard that departs in numerous material respects from the statute, implementing regulations, and HUD's authoritative interpretations. The theories advanced by respondents below and accepted by the Eleventh Circuit impose classwide liability based on the elements that define all yield spread premiums. If accepted, these theories would eliminate altogether yield spread premiums and the critical financing options they provide.

HUD has taken a fundamentally different view of the utility and legality of yield spread premiums. The 2001 Policy Statement was issued in relevant part to respond directly to *Culpepper III*, and HUD expressly rejects each of the Eleventh Circuit's bases for RESPA liability. Remanding to the Eleventh Circuit for reconsideration in light of the 2001 Policy Statement is especially appropriate in these circumstances, given the need for clarity and national uniformity that Congress, lenders, brokers, and borrowers all demand.

ARGUMENT

I. THE DECISION BELOW THREATENS TO ELIMINATE A FINANCING TOOL THAT FOSTERS HOME OWNERSHIP.

A. HUD, CONSUMERS, AND INDUSTRY AGREE THAT YIELD SPREAD PREMIUMS BENEFIT AND EXPAND THE AVAILABILITY OF HOME LOANS.

Amici share Irwin's view that yield spread premiums allow borrowers to finance some or even all of the up front costs they would otherwise have to pay to obtain a loan. So used, yield spread premiums enable borrowers to trade off up front closing costs for incrementally higher interest rates to best suit their individual financial circumstances and preferences.

Long aware of the practice and its potential benefits, HUD has now confirmed the validity of Irwin's and Amici's perspective on the utility of yield spread premiums, a view HUD also confirms is shared by consumers as well.[5] HUD's 2001 Policy Statement concisely summarizes the uses of yield spread premiums as follows:

> One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs is the up front cash needed

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[5] Before formulating the 1999 and 2001 Policy Statements, HUD consulted with consumer groups, the lending industry, and government agencies. 64 Fed. Reg. 10084; 66 Fed. Reg. 53052; HUD News Release No. 01-105 (Oct. 15, 2001), *available at* http://www.hud.gov/news/release.cfm?content=pr01-105.cfm.

to obtain a mortgage. The closing costs and origination fees associated with a mortgage loan are a significant component of these up front cash requirements. Borrowers may choose to pay these fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by financing them; *i.e.*, adding the amount of such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. **For those without the available cash, who are at the maximum loan-to-value ratio, or who simply choose to do so, there is a third option. This third option is a yield spread premium.**

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as "indirect" fees and are referred to as yield spread premiums.

A yield spread premium is calculated based upon the difference between the interest rate at which the broker originates the loan and the par, or market, rate offered by a lender. **The Department believes, and industry and consumers agree, that a yield spread premium can be a**

> **useful means to pay some or all of a borrower's settlement costs.** In these cases, lender payments reduce the up front cash requirements to borrowers. In some cases, borrowers are able to obtain loans without paying any up front cash for the services required in connection with the origination of the loan. Instead, the fees for these services are financed through a higher interest rate on the loan. **The yield spread premium thus can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership.**

66 Fed. Reg. 53053-54 (emphasis added).

Consistent with this perspective on how yield spread premiums can afford borrowers a valuable financing option, the MBA has taken a leadership role in creating model, voluntary, and supplemental borrower disclosures for its members to use. These disclosures further explain to borrowers the choices they have to compensate their broker – through direct payments, yield spread premiums financed through higher interest rates, or some combination of the two – and encourage borrowers to negotiate the arrangement which best suits their particular financial needs. While recognizing that such additional disclosures are not required under RESPA, HUD has commended and encouraged the MBA's efforts. 64 Fed. Reg. at 10087.

B. THE 2001 POLICY STATEMENT ILLUSTRATES HOW *CULPEPPER III*, IF ALLOWED TO STAND, WOULD MAKE YIELD SPREAD PREMIUMS PER SE ILLEGAL.

HUD's explanation of the lawful and beneficial use of yield spread premiums is entirely irreconcilable with *Culpepper III*. The Eleventh Circuit's analysis would have legality turn on facts inherent in all yield spread premiums. More specifically, the decision below permits liability to rest on:

- An analysis of the first step of HUD's two-part test, and of the yield spread premium in isolation from the broker's total compensation;
- The lender's intent in making the payment;
- The fact that yield spread premiums are paid only on "above par" loans, as reflected on rate sheets; and
- The fact that the lender may not know all the goods, services, or facilities the broker provides.

Recognizing the import of *Culpepper III*, the 2001 Policy Statement made it abundantly clear that HUD expressly "disagrees with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy" found in *Culpepper III*. 66 Fed. Reg. 53054-55. HUD elaborates, for example, by stating:

> It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the

> broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.

66 Fed. Reg. 53055. Underscoring the way in which *Culpepper III*'s theories of liability would, if accepted, render all yield spread premiums *per se* illegal, HUD further notes that "[y]ield spread premiums are by definition derived from the interest rate." *Id.*

HUD similarly explains that a lender's use of rate sheets "does not indicate whether a particular yield spread premium is a payment for goods and facilities actually furnished or services actually performed . . . " *Id.* The legality of yield spread premiums "cannot be determined by the use of a rate sheet . . . " *Id.*

The 2001 Policy Statement also properly rejects the "lender intent controls" line of reasoning in *Culpepper III*. 66 Fed. Reg. 53054. HUD properly interprets RESPA to focus on how the yield spread premium is actually used, not on the lender's alleged reason for the payment. That construction is particularly reasonable because Section 8(a) makes both payee (the broker) and payor (the lender) equally liable for a referral fee.[6] 12 U.S.C. §§ 2607(a) and (d)(2). The liability of each turns ultimately on precisely the same inquiry – was the payment for goods, services, or facilities? *Id.* § 2607(c)(2). If the broker uses the yield spread premium to pay for his services, the payment is

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[6] Although *Culpepper III* characterized as "bizarre" the liability test advanced by HUD because it would make the lender's liability turn on the broker's conduct, under *Culpepper III*, broker liability turns on the *lender's* intent.

admittedly payment for services, and the broker is not liable. *Id.* The statute does not permit the lender in the same transaction to be treated any differently.

Moreover, RESPA has always been concerned with the ultimate use and impact of the payment. *See* 12 U.S.C. § 2601 (RESPA designed to curtail "unnecessarily high settlement charges caused by" referral fees). Accordingly, HUD's analysis begins by describing how yield spread premiums can allow borrowers to lower their up front costs.[7] For the same reason, both the 1999 and 2001 Policy Statements emphasize the important role borrower-broker negotiations play in the legitimate use of yield spread premiums. *See, e.g.*, 64 Fed. Reg. 10087 (borrower disclosure and agreement relevant to whether fee is for services); 66 Fed. Reg. 53056. HUD's test recognizes that, regardless of the alleged reason a lender pays the yield spread premium, if the broker actually uses it to pay the very same costs otherwise paid directly by the borrower, those closing costs have not increased and RESPA's purpose has been achieved. Once again, HUD's construction is fundamentally at odds with *Culpepper III*.

In *Culpepper III*, the court stated that it was not articulating a *per se* rule of liability because, under its analysis, lender compensation would be lawful if it "bore the hallmarks of a fee-for-service exchange." *Culpepper III*, 253 F.3d at 1331. The only such example provided by the court was a payment pursuant to a broker's invoice. *Id.*

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[7] Yield spread premiums can actually save borrowers hundreds of dollars where the borrower refinances the loan before "repaying" the yield spread premium through marginally higher monthly interest payments.

Leaving aside questions about whether such an analysis avoids *per se* liability only by essentially redefining yield spread premiums, or whether such a regime could practically or lawfully be implemented given other regulatory constraints facing lenders and brokers, what is clear is that invoicing plays absolutely no role in HUD's analysis, and for good reason. Nothing in RESPA or its regulations creates a preference for one method of paying for services (*i.e.*, by itemized invoice) over another (*i.e.*, by commission). If the payment was *for* services, no matter how made, Congress made it abundantly clear that it cannot be construed as prohibited. 12 U.S.C. § 2607(c)(2).

The assumptions *Culpepper III* made about the form that lawful payments for broker services would take are unsupported and depart from actual practice. In fact, respondents and other plaintiffs in these cases vigorously assert that their payment to the brokers was compensation *for* the brokers' services. Yet such plaintiffs are not given any accompanying invoice. Instead, like lenders, borrowers typically compensate brokers on a commission basis – as a percentage of the loan amount. 64 Fed. Reg. 10081. HUD correctly determined that such compensation methods qualify as "payment for services" when used by lenders just as much as when used by borrowers. Given its oversight of an industry where commission-based compensation is common (*e.g.*, realtors), HUD's peculiar expertise in deciphering when yield spread premiums bear "the hallmarks of a fee-for-service exchange" should be respected.

HUD issued the 2001 Policy Statement, in relevant part, for the express purpose of refuting *Culpepper III* and

thereby clarifying its position on the proper interpretation of RESPA and the 1999 Policy Statement. 66 Fed. Reg. 53052. HUD's position is reasonable, and irreconcilable with *Culpepper III*'s interpretations of the test for liability upon which respondents' theories depend.

II. UNLESS RECONSIDERED, *CULPEPPER III* WILL CONTINUE TO CREATE PRECISELY THE TURMOIL CONGRESS SOUGHT TO AVOID.

After hearing testimony on the proliferation of yield spread premium class actions in 1998,[8] Congress expressed concern about the "legal uncertainty" surrounding the test for liability in these cases, particularly in light of the fact that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Section 8 of RESPA]." H.R. CONF. REP. No. 105-769 (1998), *reprinted in* 1998, U.S.C.C.A.N. 539, 568. Congress then specifically "direct[ed]" HUD to issue a "policy statement" in order "to clarify its position" and provide "guidance to . . . the courts." *Id.*

The 1999 Policy Statement represented HUD's congressionally mandated effort to promote national uniformity on the legality of yield spread premiums under existing law. Amici's members, especially those who had faced years of costly litigation in these cases, justifiably

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[8] *See* Reform of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA): Hearing Before the House Comm. on Banking and Fin. Servs., 105th Cong. at 22-28, 50, 275 (July 22 and Sept. 16, 1998).

relied on the 1999 Policy Statement as having finally eliminated litigable issues relating to the governing standard for liability. Indeed, district courts overwhelmingly agreed, and interpreted the 1999 Policy Statement to articulate the two-part test Irwin advocated below.

By finding the 1999 Policy Statement ambiguous, and formulating a legal test entirely separate from the one advanced by HUD, *Culpepper III* has plunged lenders, brokers, consumers, and courts into the same chaotic state that led Congress to direct HUD to act in the first place. A new wave of over 40 nationwide class actions challenging yield spread premiums under RESPA were filed in the immediate aftermath of *Culpepper III*. Over 80 putative class actions are still pending in district courts around the country, with a particularly heavy concentration in the Eleventh Circuit.[9] The risk of inconsistent determinations on the solitary federal statute at issue in these cases is very real. Already, several district courts outside the Eleventh Circuit have refused to follow *Culpepper III*'s RESPA liability analysis, according HUD's Policy Statements deference instead. *Bjustrom v. Trust One Mortgage Corp.*, No. C-001166P, 2001 U.S. Dist. LEXIS 17890 (W.D. Wash. Oct. 26, 2001); *Vargas v. Universal Mortgage Corp.*, No. 01 C 0087, 2001 U.S. Dist. LEXIS 19635 (N.D. Ill. Nov. 29, 2001). The specter remains that district courts within the Eleventh Circuit, including the one before which the instant case now resides, will feel more constrained to depart from *Culpepper III*.

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[9] *See* Appendix A.

Inconsistency in the governing legal standard is particularly problematic for Amici's members. Most wholesale lenders make loans in a variety of geographic regions, and a large number have truly nationwide operations. There are many lenders who have already successfully defended prior RESPA challenges to their payment of yield spread premiums, typically at costs ranging in the hundreds of thousands of dollars. Many of these same mortgage lenders are already facing, and many others soon may face, renewed litigation in the Eleventh Circuit where they may be subject to the very different liability standards of *Culpepper III*. This threat alone has required individual lenders to give serious consideration to halting or geographically limiting the practice of offering yield spread premiums, despite its admitted consumer benefits.

III. PLENARY REVIEW IS ALSO FULLY JUSTIFIED IN LIGHT OF ELEMENTARY FLAWS IN *CULPEPPER III*'S CONSTRUCTION OF HUD'S TEST.

In other significant respects, the decision in *Culpepper III* violates the cardinal principle of statutory construction that one must give effect, where possible, to every clause. This Court has cautioned: "Over and over we have stressed that 'in expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law.' " *United States Nat'l Bank v. Independent Ins. Agents, Inc.*, 508 U.S. 439, 455 (1993) (quotation omitted). "[I]solated words or sentences" are not "a reliable guide for discovery of a statute's meaning." *Id.* (quotation omitted). Thus, a court may not adopt an interpretation because it is plausible

when a clause is examined "in isolation." *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 809 (1989). This rule of statutory construction applies with equal force to agency pronouncements. *See Wright v. Director, Fed. Emergency Mgmt. Agency*, 913 F.2d 1566, 1572 (11th Cir. 1990) (applying rule of statutory construction to agency regulation).

There is no one section in the 1999 Policy Statement that recites HUD's test. Rather, various articulations of the two-part test are found throughout. In construing the first prong of the HUD test, *Culpepper III* erroneously fixed on a single isolated phrase in the 1999 Policy Statement – whether "services were actually performed *for* the compensation paid," 64 Fed. Reg. at 10084 (emphasis added) – and construed it to mean "that the first step in the test for liability under § 8 is not only whether the broker performed some of the services described in the HUD Statement, but also whether the yield spread premium is payment for those services." *Culpepper III*, 253 F.3d at 1331.

That construction is impossible to reconcile with the remainder of the 1999 Policy Statement. Although HUD initially states: "the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid," 64 Fed. Reg. 10084, HUD then immediately clarifies the limited scope of this first inquiry (*i.e.*, that it asks *only* whether goods or facilities *were furnished*, or whether services *were performed*) by going on to state:

> **The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does**

> **not by itself make the payment legal.** The **second question** is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

64 Fed. Reg. 10084 (emphasis added). HUD later reiterates the same point:

> **The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker . . . does not by itself make a payment by a lender to a mortgage broker legal.** The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

64 Fed. Reg. 10085-86 (emphasis added). The *Culpepper III* analysis of the first prong of HUD's test makes no mention of these repeated admonitions from HUD regarding how the test is properly applied. Instead, emanating as it does from an isolated clause, the *Culpepper III* reading of HUD's test is incompatible with the language of the 1999 Policy Statement as a whole.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

GREGORY P. DRESSER
Counsel of Record
JAMES F. MCCABE
MICHAEL J. AGOGLIA
MORRISON & FOERSTER LLP
425 Market Street
San Francisco, CA 94105-2482
(415) 268-7000

APPENDIX A

Pending Yield Spread Premium Class Actions by Federal Judicial Circuit*

*Pending class actions against mortgage bankers challenging the payment of yield spread premiums

Pending Yield Spread Premium Class Actions

Alexander v. America's Wholesale Lender	3:01CV7342 (N.D. Ohio)
Allen v. Fleet Mortgage Corp.	97-DV0065 MJL (E.D.N.Y.)
Alvarez v. American General Finance, Inc.	1:01CV4648 (N.D. Ill.)
Andrews v. Temple Inland Mortgage Corp.	0:00CV1999 (D. Minn.)
Auron v. Standard Federal Bank	98-CV-758 (D. Minn.)
Barnes v. Norwest Mortgage, Inc.	4:98-CV-9 (JRE) (M.D. Ga.)
Beggs v. Irwin Mortgage Corp.	1:01CV2205 (N.D. Ala.)
Bennett v. Saxon Mortgage	98-913 JO (D. Or.)
Bjustrom v. Trust One Mortgage Corp.	C00-1166 (W.D. Wash.)
Briggs v. Countrywide Funding Corp.	95-D-859-N (M.D. Ala.)
Brigham v. North American Mortgage Co.	4:98-CV-10 (JRE) (M.D. Ga.)
Cedeno v. Fieldstone Mortgage Co.	01C5110 (N.D. Ill.)
Chandler v. Hilton Mortgage Corp.	94-CV-01418 (M.D. Ala.)
Claiborne v. Bank of America Corp.	1:01CV2235 (N.D. Ill.)
Costa v. SIB Mortgage Corp.	01CIV7040 (S.D.N.Y.)
Crowell v. ABN AMRO Mortgage Group, Inc.	01-2165 (C.D. Ill.)

Culpepper v. Inland Mortgage Corp.	2:96CV917 (N.D. Ala.)
Davis v. First Union Mortgage Corp.	99-1494 (S.D. Fla.)
Dennison v. New Freedom Mortgage Corp.	01-4191 (S.D. Fla.)
Dominguez v. Alliance Mortgage Co.	01C7213 (N.D. Ill.)
Dresslar v. FT Mortgage Co.	9:98-CV-11 (JRE) (M.D. Ga.)
Dujanovic v. Mortgage-america, Inc.	2:98-CV-235 (N.D. Ala.)
Empalmado v. First Franklin Financial Corp.	1:01CV1117 (N.D. Ill.)
Farr v. First Horizon Home Corp.	3:01CV1726 (N.D. Tex.)
Galbrecht v. Union Planters Bank. NA	2:01CV2268 (N.D. Ala.)
Gardner v. First Franklin Financial Corp.	4:01CV427-WS (N.D. Fla.)
Geraci v. Homestreet Bank	C01-1465Z (W.D. Wash.)
Glover v. Standard Federal Bank	97-2068 ADM/AJB (D. Minn.)
Gonzalez v. GN Mortgage Corp.	1:01CV4369 (N.D. Ill.)
Grant v. Innovative Mortgage Co., Inc.	94 CV 01599 (M.D. Ala.)
Grimes v. Fleet Mortgage Corp.	2:98-CV-234 (N.D. Ala.)
Guillen v. Fieldstone Mortgage	01C6179 (N.D. Ill.)

Hall v. Crossland Mortgage Corp.	2:01CV225 (N.D. Ala.)
Harris v. Meritage Mortgage Corp.	99CV2345 (N.D. Ala.)
Heam v. Washtenaw Mortgage Co.	4:98-CV-78 (M.D. Ga.)
Heimmermann v. First Union Mortgage Corp.	CV-98-J-2357-NW (N.D. Ala.)
Heirs v. Irwin Mortgage Corp.	2:98CV2187 (N.D. Ala.)
Hirsch v. BankAmerica Corp.	1:98-CV-1032 (ODE) (N.D. Ga.)
Hunter v. Equicredit Corp.	4:01CV393-RH (N.D. Fla.)
Jackson v. Long Beach Mortgage Co.	1:01CV1123 (N.D. Ill.)
Jacobs-Allender v. Wells Fargo Home	1:01CV2690 (D. Md.)
Johnson v. Equicredit Corp. of America	01C5197 (N.D. Ill.)
Jones v. Mical Mortgage, Inc.	4:98-CV-12 (JRE) (M.D. Ga.)
Kolle v. SBG Corp.	1:01CV5708 (N.D. Ill.)
Krest v. Equicredit Corp. of America	C301-275 (S.D. Ohio)
Kroskin v. Aggressive Mortgage Corp.	98-CV-600 (D. Minn.)
Krzalic v. American Home Mortgage Corp.	1:01C9107 (N.D. Ill.)

LaCasse v. Washington Mutual Bank	C01-1352Z (W.D. Wash.)
Legg v. First Franklin Financial Corp.	CV00BU-1328 E (N.D. Ala.)
Lombardi v. WMC Mortgage Corp.	99-CV-7554 (E.D.N.Y.)
Marbury v. Colonial Mortgage	2:98-0CV-355 (M.D. Ala.)
McBride v. Reliastar Mortgage Corp.	1:98-CV-215 JEC (N.D. Ga.)
McDuffie v. North American Mortgage Co.	94-T-1400-N (M.D. Ala.)
Medlock v. Chase Manhattan Mortgage Corp.	4:98 CV-14 (JRE) (M.D. Ga.)
Michalowski v. Flagstar Bank, FSB	1:01CV6095 (N.D. Ill.)
Mortera v. North American Mortgage Co.	3:01CV2790 (N.D. Cal.)
Ngo v. New Century Mortgage Corp.	1:01-CV-2997 (N.D. Ga.)
Olson v. Equicredit Corp.	01-30 119-MAP (D. Mass.)
Orr v. Equicredit Corp. of Pennsylvania	01-256 (W.D. Penn.)
Perry v. Mid South Mortgage, Inc.	CV-98-C02305-W (N.D. Ala.)
Perry v. New Century Mortgage Corp.	1:01CV11173 (D. Mass.)
Perry v. Resource Bancshares Mortgage Group	98-T-785-N (M.D. Ala.)

Pullie v. Citimortgage Corp.	CV-01-B-1832-S (N.D. Ala.)
Richardson v. Bankamerica Corp.	1:98-CV-1031 (ODE) (N.D. Ga.)
Richter v. Banc One Mortgage Corp.	97CV02195 (D. Ariz.)
Riviera v. Fairbanks Capital Corp.	1:01CV1138 (D.N.M.)
Rollins v. ProBank	95 CV 00883 MHT (M.D. Ala.)
Ruff v. Associates Home Equity Services, Inc.	C301-343 (S.D. Ohio)
Samuel v. Bank of America	2:00CV6196 (E.D. Pa.)
Schneider v. Citicorp Mortgage, Inc.	97-CV-837 (E.D.N.Y.)
Schubach v. Corinthian Mortgage	0:01CV1623 (D. Minn.)
Schuetz v. Banc One Mortgage Corp.	2:98-CV-284 (D. Ariz.)
Simeon v. American Residential Mortgage Corp.	3:01CV1363 (D. Conn.)
Sims v. Unicor Mortgage, Inc.	98-P-11662-S (N.D. Ala.)
Sinitsyn v. Washington Mutual Bank	C01-1772 (W.D. Wash.)
Taggart v. Great Eastern Financial Services	98-C-1697-W (N.D. Ala.)
Taylor v. Flagstar Bank	2:98CV50 (M.D. Ala.)

Thomas v. CIT Group Consumer Finance, Inc.	3:01CV267 (S.D. Ohio)
Thomas v. Ocwen Federal Bank	01 C 4249 (N.D. Ill.)
Trombley v. First Union Mortgage Corp.	4:98-CV-19 (JRE) (M.D. Ga.)
Vargas v. Universal Mortgage Corp.	1:01CV87 (N.D. Ill.)
Watson v. CBSK Financial Group, Inc.	1:01CV4043 (N.D. Ill.)
Williams v. Pacor Mortgage Corp.	1:01CV255 (N.D. Ill.)
Wilson v. Commercial Federal Mortgage	2:98-CV-184 (N.D. Ala.)

Supreme Court, U.S.
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No. 01-695

In the Supreme Court of the United States

IRWIN MORTGAGE CORPORATION,
PETITIONER,

v.

JOHN ROBERT CULPEPPER, PATRICIA STARNES CULPEPPER, ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED, AND BEATRICE N. HIERS, INDIVIDUALLY AND AS A REPRESENTATIVE OF A CLASS OF SIMILARLY SITUATED INDIVIDUALS,
RESPONDENTS.

REPLY BRIEF FOR PETITIONERS

MAUREEN E. MAHONEY
NESTOR M. DAVIDSON
LATHAM & WATKINS
555 ELEVENTH ST., N.W.
SUITE 1000
WASHINGTON, D.C. 20004
(202) 637-2200

*ALAN H. MACLIN
ROBERT J. PRATTE
BRIGGS AND MORGAN
2400 IDS CENTER
80 SOUTH EIGHTH STREET
MINNEAPOLIS, MN 55402
(612) 334-8400
*Counsel of Record

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64 Fed. Reg. 10,080 (Mar. 1, 1999) 1
66 Fed. Reg. 53,052 (Oct. 18, 2001) 1

OTHER AUTHORITY

Fed. R. Civ. P. 23(f) Advisory Committee's Notes 3, 4

Respondents' attempts to avoid the import of HUD's rejection of the decision of the Court of Appeals below in no way undermines the compelling case Petitioner has presented for the exercise of this Court's power to grant, vacate and remand. The Court of Appeals squarely decided that HUD's 1999 Policy Statement[1] established the governing test for liability for the payment of yield spread premiums under RESPA, 12 U.S.C. § 2607, but that HUD's test was ambiguous. The Court of Appeals resolved that ambiguity one way. HUD has now rejected the Eleventh Circuit's interpretation and resolved the same ambiguity in precisely the opposite way.[2]

There is no legal or prudential basis for Respondents' assertion that this Court should deny relief so that the pure questions of law at issue here could be litigated (again) in the District Court. The Court of Appeals, in granting Petitioner's Rule 23(f) petition, already decided that the resolution of the legal issues presented here should not be postponed until an ultimate decision on the merits. None of Respondents' arguments alter that calculus, and Respondents do not even contend that they will suffer prejudice from a remand to the Court of Appeals. Indeed, a remand is particularly compelling given that the Eleventh Circuit is currently considering the very same issues in three companion cases.

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[1] Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers; Final Rule, 64 Fed. Reg. 10,080 (Mar. 1, 1999) (Pet. App. 77a) ("1999 Policy Statement").

[2] Real Estate Settlement Procedures Act (RESPA) Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule, 66 Fed. Reg. 53,052 (Oct. 18, 2001) (Pet. App. 107a) ("2001 Policy Statement")

Finally, the lengths that Respondents go to undermine the validity and authoritative strength of HUD's 2001 Policy Statement are largely beside the point. While the Policy Statement is entitled to the highest level of deference, this Court made clear in *Lawrence v. Chater*, 516 U.S. 163 (1996) (per curiam), that such issues should be addressed in the first instance by Courts of Appeals. Whether HUD's statement is binding under *Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984) and *Auer v. Robbins*, 519 U.S. 452 (1997), as Petitioner maintains, or is merely entitled to great deference under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), the grounds for granting, vacating and remanding the Petition remain strong.[3]

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[3] Respondents challenge a number of the factual assertions outlined in the Petition, primarily with respect to the details of Respondents' loan closings. Brief in Opposition at 12-15. Petitioner strongly disagrees with Respondents' characterization of the facts, and the record supports all of Petitioner's assertions. Moreover, the courts below have made no findings of fact, as this case was appealed on the class certification issue and Respondents' motion for summary judgment is still pending before the District Court. Such attacks, however, are entirely irrelevant to the issues before this Court. The only question before the Court of Appeals was the propriety of class certification, an issue the Court decided based on what it determined to be the legal standard for liability under RESPA. The heart of the Court of Appeals' conclusion was the proposition that class certification was appropriate under the 1999 Policy Statement's test because the individual facts of any given transaction did not matter. The fact that Respondents argue so vigorously over fractions of percentages of commissions paid in the named plaintiffs' transactions merely underscores the importance of taking each transaction on a case-by-case basis rather than approaching Petitioner's liability on a class-wide basis.

ARGUMENT

I. THE PROCEDURAL POSTURE OF THIS CASE MAKES THE EXERCISE OF THIS COURT'S AUTHORITY TO GRANT, VACATE AND REMAND MORE, NOT LESS, COMPELLING.

1. There can be no dispute that the 2001 Policy Statement represents a significant intervening development. Respondents' principal argument against remanding this case to the Court of Appeals for reconsideration instead turns on their mistaken view that the interlocutory nature of the appeal warrants deference to the District Court in the first instance, both because the Court of Appeals ultimately will have an opportunity to hear Petitioner's arguments and because other grounds might render moot the issues decided by the Court of Appeals. Brief in Opposition at 18-21. In fact, the opposite is true.

To begin with, contrary to Respondents' blanket assertion, this Court regularly GVRs interlocutory appeals. *See, e.g., Household Int'l Tax Reduction Inv. Plan v. Matz*,— U.S. —, 121 S. Ct. 2545 (2001) (interlocutory appeal; granted, vacated, and remanded in light of *United States v. Mead*, 533 U.S. 218 (2001)); *Illinois St. Univ. v. Varner*, 528 U.S. 1110 (2000) (interlocutory appeal; granted, vacated, and remanded in light of *Kimel v. Florida Bd. of Regents*, 528 U.S. 62 (2000)). Nor is there a basis to draw a distinction between final and interlocutory decisions in this regard: by their very nature, appeals that have been certified for interlocutory review involve a narrow category of issues that warrant appellate review prior to the conclusion of the litigation in the District Court, *see, e.g.*, 28 U.S.C. §1292(b).

This case reached the Court of Appeals under Federal Rule of Civil Procedure 23(f), which grants appellate courts

discretionary authority to allow interlocutory appeals when, among other considerations, "as a practical matter, the decision on certification is likely dispositive of the litigation." Advisory Committee Notes to Rule 23(f). The Advisory Committee has likened the decision on a Rule 23(f) motion "to the discretion exercised by the Supreme Court in acting on a petition for certiorari." *Id.* Thus the fact that the Court of Appeals granted Petitioner's Rule 23(f) motion reflects the considered judgment of that Court that the issue of certification should not wait until final resolution, and Respondents offer no arguments as to why the Court of Appeals' judgment on that point should be relitigated now.

Moreover, the fact that the Court of Appeals will have the opportunity to revisit the fundamental question of the standard of liability under RESPA (and thus the propriety of class certification under that standard) argues strongly in favor of having such dispositive issues resolved now rather than at the end of protracted litigation in the District Court. Respondents clearly will not be prejudiced by an immediate return to the Court of Appeals, given their acknowledgment that the Court of Appeals will be the ultimate arbiter (short of a resolution by this Court) of the legal decisions made in the course of this litigation. All of the parties to this case have a strong interest in avoiding needless litigation, and any further proceedings in the District Court following the decision of the Court of Appeals on remand from this Court would be free from the pall of doubt that HUD's 2001 Policy Statement has now cast on the case below.[4]

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[4] It is surprising to say the least that Respondents argue that the legal questions at issue in this case would benefit from further development of the record in the District Court. Brief in Opposition at 18-19. Respondents have consistently maintained, in an argument the Court of Appeals below essentially adopted wholesale, *see* n. 3, *supra*, that none of the factual matters potentially worthy of development with respect to

As Respondents acknowledge, the Eleventh Circuit has asked for briefing on the very issues pending in the Petition, *see* Brief in Opposition at 19 n.6; *see also* Pet. App. 140a-45a. It makes no sense to have the Eleventh Circuit resolve the issues raised in the Petition in three companion cases without also doing so at the same time in the one case in which the Court of Appeals has already ruled. For all of these reasons, it is critical for the efficient and fair resolution of this litigation to return the case to the Court of Appeals immediately.[5]

2. Despite Respondents' assertion to the contrary, most of the issues Respondents raise as potentially mooting the questions presented in the Petition are not before the District Court, even though, as Respondents point out, there has been full briefing on both the merits and the supplemental issues raised by the 2001 Policy Statement. *See* Brief in Opposition at 18. Specifically, neither the question whether applying the HUD 2001 Policy Statement to such an on-going case would render its application retroactive nor the alternative class definitions Respondents now posit have been raised or argued on remand from the decision below and are thus not before the District Court.

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individual loan transactions have relevance to their basic theory of liability—namely that because Petitioner pays yield spread premiums based on terms and conditions common to all loans, such payments are categorically illegal under RESPA.

[5] Petitioner has moved for a stay of the District Court proceedings pending resolution of the Court of Appeals' consideration of the impact of HUD's 2001 Policy Statement in the three companion cases to the case below. In at least one district court case in the Eleventh Circuit a stay (by stipulation) has been granted in recognition of the importance of having the Court of Appeals resolve the fundamental issues called into doubt by the 2001 Policy Statement. *Beggs v. Irwin Mortgage Corp.*, Stipulation and Order for Stay of Proceedings, Case No. CV-01-HGD-2205-E (N.D. Ala. Dec. 6, 2001).

With respect to the law-of-the-case doctrine, which Respondents did raise before the District Court, there is nothing to be gained from resorting to the District Court in the first instance. Both parties agree that the issue will not be settled until the Court of Appeals addresses it. Any decision by the District Court on law-of-the-case grounds certainly would in no way moot the question pending before this Court.

3. Respondents' third argument against remanding to the Court of Appeals now—the contention that the Court of Appeals has fully considered and "repeatedly rejected" the standard clarified in the 2001 Policy Statement—is fundamentally wrong.[6] Despite Respondents' selective quotations from the decision below, what the Court of Appeals actually decided was that the test set forth in the 1999 Policy Statement controls the analysis of liability for the payment of yield spread premiums under RESPA, Pet. App. 5a; that the test is "imbue[d] with the force of law," *id.*; that the 1999 Policy Statement "is ambiguous," *id.* 6a; and that, in the Court's view, Respondents' resolution of that ambiguity had greater merit, *id.* 8a-13a. In this final judgment the Court of Appeals erred, as the 2001 Policy Statement has now made clear, but the critical point is that the Court never ruled that the HUD test does not control

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[6] Respondents are trying to have it both ways with respect to whether the Court of Appeals has considered the 2001 Policy Statement. Contrary to what Respondents have argued before this Court, in the District Court respondents argued that the 2001 Policy Statement "clearly articulates a new standard" of liability, that it is "HUD's new interpretation" of the 1999 Policy Statement, and that the 2001 Policy Statement "is inconsistent with [HUD's] prior formal . . . pronouncement[ ] [in the 1999 Policy Statement]." Plaintiff's Response to Oct. 31, 2001 Court Order at 5, 8, 17.

nor that the language of RESPA requires (as opposed to recommends) any specific interpretation of that test.[7]

Had the Court of Appeals felt that RESPA mandated a given rule of liability, there would have been no reason to grapple with the ambiguity the Court found in the 1999 Policy Statement, because, as this Court has made clear on numerous occasions, if Congress has spoken to a given issue, that settles the question. *See, e.g., NationsBank of N.C. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251, 257 (1995) (stating that if "'the intent of Congress is clear . . . that is the end of the matter.'" (quoting *Chevron*, 467 U.S. at 842)). Equally telling is the fact that the Court of Appeals has asked for briefing on the impact of the 2001 Policy Statement, indicating that the Court does not consider the issues raised by that Policy Statement resolved. In short, the only question the Court of Appeals actually decided below was which of two reasonable interpretations of the standard for liability under RESPA HUD had chosen, and HUD has now spoken to the contrary.

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[7] The instances in which the Court of Appeals adverted to the language of the statute were not considered judgments about what RESPA requires, but rather applications of an interpretative tool analogous to the way courts interpret ambiguous statutes so as to avoid raising constitutional questions while carefully declining to rule on the constitutional provisions themselves. *See, e.g., De Bartolo Corp. v. Florida Gulf Coast Bldg. and Constr. Trades Council*, 485 U.S. 568, 575 (1988). Thus, for example, the Court of Appeals indicated that Section 8(c) "implies" a direct link between specific services and any given element of total compensation, that everything about 8(c) "suggests" that it is a gloss on 8(a), and that "[i]f" that is so, "we should avoid reading" the provision in line with an interpretation of the HUD test that would create a perceived internal tension in Section 8. Pet. App. 10a-11a. Petitioner disagrees with this interpretation, but regardless of the merits, it is clear that the Court of Appeals did not treat the statutory question as squarely presented.

II. STRONG GROUNDS EXIST FOR GIVING HUD'S INTERPRETATION BINDING DEFERENCE AND THIS ISSUE DOES NOT UNDERMINE THE IMPORTANCE OF RECONSIDERATION BELOW.

Respondents argue that a GVR is not appropriate because the 2001 Policy Statement is not entitled to binding deference. As Petitioner has noted, however, this argument is largely beside the point. This Court has held that an intervening agency interpretation may be the basis of a GVR order if that agency interpretation "is reasonably probably entitled to deference." *Lawrence*, 516 U.S., 172. Indeed, in *Lawrence*, the Court GVR'd in light of a change in interpretation announced in a litigation brief. *Id.* at 165. Thus there is no need for this Court to determine whether the 2001 Policy Statement is due binding *Chevron* deference or merely persuasive *Skidmore* deference in order to GVR.

None of the arguments Respondents put forward, however, call into serious question the proposition that the HUD test, articulated in the 1999 Policy Statement and clarified in the 2001 Policy Statement, is entitled to the highest deference. *Christiansen v. Harris County*, 529 U.S. 576 (2000), involved an informal opinion letter that lacked the force of law. In sharp contrast, the 2001 Policy Statement was issued pursuant to an explicit grant of authority by Congress to issue binding interpretations of RESPA, *see* 12 U.S.C. § 2617(a), and was published by HUD in the Federal Register, as prescribed by RESPA and the Administrative Procedures Act, 5 U.S.C. § 552. This Court only last Term reaffirmed, moreover, that notice-and-comment rulemaking and formal adjudication are not the sole categories of administrative action entitled to *Chevron* deference. *See United States v. Mead Corp.*, 533 U.S. 218, 306 (2001) (citing *NationsBank*, 513 U.S. at 256-57).

Respondents also ignore entirely the proposition that to the degree the 2001 Policy Statement is a clarification of the 1999 Policy Statement it is "controlling" unless "plainly erroneous or inconsistent" with the earlier interpretation. *Auer*, 519 U.S. at 461. Respondents do not challenge the Court of Appeal's conclusion that the 1999 Policy Statement is binding and an important rationale for the kind of deference reaffirmed in *Auer*—that the entity most qualified to clarify an ambiguity in an administrative pronouncement is the entity that promulgated it—applies fully in this case.

Finally, Respondents' arguments with respect to Section 8(c)(5) of RESPA simply have nothing to do with this case. HUD itself made clear in unmistakable terms that both the 1999 and 2001 Policy Statements were promulgated under the general grant of authority to implement RESPA found in Section 19(a) of RESPA.[8] *See* Pet. App. 92a, 109a. Section 8(c)(5) of RESPA is not, as Respondents claim, a distinct source of authority to interpret and implement RESPA. It is, rather, specific authority to create categories

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[8] There can be no doubt that Congress in this provision clearly delegated to HUD broad authority to implement RESPA. Section 19(a) of RESPA provides that "[t]he Secretary [of HUD] is authorized to prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this Act." 12 U.S.C. § 2617(a) This delegation language is indistinguishable from that found in any number of statutory regimes this Court has found to indicate Congressional intent to grant broad implementing authority. *See, e.g., AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366, 378 (1999) (citing 47 U.S.C. § 201(b)'s grant of authority to the FCC to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this chapter"); *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 496 n.15 (1996) (citing 21 U.S.C. § 371(a)'s grant of authority to the FDA "to promulgate regulations for the efficient enforcement of this Act").

of exempt payments beyond those specified in Section 8(c).[9] The canon of construction that the more specific statutory provision controls only applies where both provisions cover the same subject. The authority to create additional exceptions from Section 8 liability provided in Section 8(c)(*5*), however, in no way clashes with HUD's authority to act pursuant to Section 19(a) to fill in gaps left by Congress in the application of the exception from liability already set forth in Section 8(c)(*2*).

CONCLUSION

The standard this Court set forth in *Lawrence* has been met in all respects and Petitioner thus urges the Court to grant the petition, vacate the decision of the Court of Appeals, and remand for reconsideration. In the alternative, for the reasons set forth in the Petition—which Respondents generally have not addressed—the Court should grant plenary review.

Respectfully submitted,

MAUREEN E. MAHONEY
NESTOR M. DAVIDSON
LATHAM & WATKINS
555 Eleventh Street, N.W.
SUITE 1000
WASHINGTON, D.C. 20004
(202) 637-2200

*ALAN H. MACLIN
ROBERT J. PRATTE
BRIGGS AND MORGAN
2400 IDS CENTER
80 SOUTH EIGHTH STREET
MINNEAPOLIS, MN 55402
(612) 334-8400
*Counsel of Record

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[9] Section 8(c) of RESPA identifies four categories of payments exempt from the prohibitions found Section 8(a) and 8(b), 12 U.S.C. §2607(c), including that at issue in this case. The Act, in Section 8(c)(5), then grants authority to HUD to specify "such other payments or classes of payments or other transfers" that are exempt from Section 8 liability, but HUD may exercise this authority only by regulation and after consultation with several other agencies and departments. *See id.* § 2607(c)(5).